The ANTITRUST BULLETIN

In This Issue

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ILLINOIS STATE BAR ASSOCIATION
SECTION ON ANTITRUST LAW

MERGERS	COST JUSTIFICATION
• John W. Gwynne	• Corwin D. Edwards
• Ward S. Bowman, Jr.	• Albert E. Sawyer
• Mark S. Massel	• Herbert F. Taggart

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INTRODUCTORY STATEMENT

The papers published in this issue of the *Antitrust Bulletin* were originally delivered at the meetings of the Antitrust Section of the Illinois State Bar Association held on November 5, 1954 and November 4, 1955. These meetings were part of the continuing program of the Section begun in 1953 to bring together annually an audience of experienced antitrust practitioners and a panel of outstanding experts in the field to consider an antitrust question of particular current interest. The subject matter of each meeting is limited to a single topic to permit intensive analysis as well as comprehensive coverage.

The subject of the 1954 meeting was "Mergers and Section 7 of the Clayton Act." The meeting was planned to focus the discussion upon the unresolved question as to the proper test to apply in determining whether an acquisition has had a substantial effect on competition. This question was examined from the point of view of the Federal Trade Commission, the economist and the practicing lawyer.

The subject of the 1955 meeting was "The Cost Justification Provisions of the Robinson-Patman Act." In view of the fact that the Advisory Committee on Cost Justification of the Federal Trade Commission has completed its research and analysis and will publish its report in the near future, this meeting was planned to review the question generally in order to provide a basis for evaluating the report and its recommendations. The Chairman of the committee, Prof. Herbert F. Taggart of the University of Michigan School of Business, participated and outlined briefly some of the conclusions of the committee.

On behalf of the Antitrust Section we wish to express our thanks to the editor of the *Antitrust Bulletin* for making it possible to bring the papers delivered at these meetings to the attention of a wider audience.

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Illinois State Bar Association

THE FEDERAL TRADE COMMISSION AND SECTION 7

by

JOHN W. GWYNNE*

By Act of December 29, 1950, Congress adopted new amendments to the Clayton Act. These amendments, together with the legislative history, suggest some interesting questions as to the interpretation of Section 7 as amended.

The first paragraph of Section 7 now reads:

> "That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition or to tend to create a monopoly." [1]

The important changes made in this paragraph are (1) the inclusion of the acquisition of assets within the scope of the statute, (2) the elimination of the competitive test between the acquiring and the acquired corporation, (3) the adoption of the words "in any line of commerce in any section of the country," and (4) a revision of the tests by which the illegality of a proposed merger is to be determined.

The original Section 7 made no attempt to prohibit mergers by acquisition of assets. The mergers of that period were usually accomplished by stock purchases. The development of holding companies, and their control (often secret) of other corporations was the primary evil which held the attention of the Congress and the public.[2]

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* Chairman, Federal Trade Commission.

1 64 Stat. 1125; 15 U. S. C. Sec. 18.

2 See report of Senate Debates, particularly statements of Senator Cummins, 51 Congressional Record 14,316; House of Representatives Report No. 1191, 81st Congress, 1st Sess., p. 4.

The interpretation of the section by the Supreme Court greatly limited its effectiveness[3] and led to demands both in and out of Congress for modification of the law. In fact "the plugging of the loopholes" caused by the failure to include assets and also by the court decisions as to stock purchases was generally given as one of the main objectives of the proposed legislation.[4]

Amended Section 7 now brings acquisitions of assets within the prohibitions of the law by the following language:

> "And no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of any other corporation," etc.

The word "assets" is not defined, although its meaning did receive some consideration in various stages of the efforts to amend the law.[5]

The original Section 7 prohibited a stock acquisition, "Where the effect of such acquisition may be to substantially lessen competition between the corporation whose stock is so acquired and the corporation making the acquisition." The amended law omits the quoted language. Both the House and Senate Judiciary Committee reports state that this omission made the law less restrictive.[6] That would no doubt be true if the clause were to be given its literal meaning. The merger of two competing corporations would seem to eliminate whatever degree of competition had existed between them. There has, however, always been considerable difference of opinion as to the meaning of the clause and for practical purposes, it came to have a limited effect.[7]

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[3] *Thatcher Manufacturing Company* v. *FTC, FTC* v. *Western Meat Company, Swift and Company* v. *FTC*, all reported in 272 U. S. 554 (1926). *Arrow-Hart and Hegeman Electric Company* v. *FTC* (1934), 291 U. S. 587.

[4] See Senate Report No. 1775, 81st Congress, 2nd Sess., p. 2.

[5] A statement of the National Canners Association suggested the following amendment: "The term 'assets' as used in this section * * * shall not include stock in trade, inventories or other property held by a corporation primarily for sale to customers in the ordinary course of its trade or business." (*Senate Hearings on H. R. 2734*, 81st Congress, 2nd Sess., p. 313.)

[6] Senate Report No. 1775, 81st Congress, 2nd Sess., p. 4; House Report No. 1191, 81st Congress, 1st Sess., p. 5.

[7] See Henderson, *The Federal Trade Commission*, pp. 40-42; dissenting memorandum of Commissioner Van Fleet in *Fiske Rubber Company* (1926), 10 FTC 433.

In any event, the elimination of all reference to lessening of competition between the acquiring and the acquired corporation has an important bearing on the interpretation of the present law. For example, it makes it clear that the prohibitions of the section are not limited to horizontal mergers. On this subject, the House Committee report says:

> "But in the proposed bill, as has been pointed out above, the test of the effect on competition by the acquiring and the acquired firm has been eliminated. One reason for this action was to make it clear that this bill is not intended to prohibit all acquisitions among competitors. But there is a second, which is to make it clear that the bill applies to all types of mergers and acquisitions, vertical and conglomerate, as well as horizontal, which have the specified effects of substantially lessening competition * * * or tending to create a monopoly. If, for example, one or a number of raw-material producers purchases firms in a fabricating field (i.e., a 'forward vertical' acquisition), and if as a result thereof competition in that fabricating field is substantially lessened in any section of the country, the law would be violated even though there did not exist any competition between the acquiring (raw material) and the acquired (fabricating) firms. The same principles would, of course, apply to backward vertical and conglomerate acquisitions and mergers." [8]

Another important change in the section was the adoption of the language "in any line of commerce in any section of the country."

The original law (omitting the competitive test between the acquiring and acquired corporations) prohibited stock acquisitions where the effect may be (1) to restrain commerce in any section or community, or (2) to tend to create a monopoly of any line of commerce. The present law prohibits acquisitions of either stock or assets whereby the effect may be (1) substantially to lessen competition in any line of commerce in any section of the country, or (2) to tend to create a monopoly in any line of commerce in any section of the country.

In regard to the words "section of the country," the Senate report points out that:

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[8] House of Representatives Committee Report No. 1191, 81st Congress, 1st Sess., p. 11.

> "Although it is, of course, impossible to define rigidly what constitutes a 'section of the country,' certain broad standards reflecting the general intent of Congress can be set forth to guide the Commission and the courts in their interpretation. What constitutes a section will vary with the nature of the product. Owing to the differences in the size and character of markets, it would be meaningless from an economic point of view to attempt to apply for all products a uniform definition of section, whether such a definition were based upon miles, population, income, or other unit of measurement. A section which would be economically significant for a heavy, durable product, such as large machine tools, might well be meaningless for a light product, such as milk." [9]

The limits of a section of the country in any particular case is not to be determined by geographical boundaries but rather by the realities of competition. Generally speaking, it is an area of effective competition—a trade area. In determining its extent, consideration should be given to many factors,—the character of the product, its practical transportability, its perishability, relation to competitors outside the area and many others.

The original law contained the words "in any section or community," as did also some of the prior bills introduced to amend Section 7. In the final version, the phrase "or community" was omitted, for the purpose of making the law less restrictive,—to prevent the test of competitive effect being applied to a governmentally or socially recognized area having no relation to the real area of effective competition.

The phrase now being considered does not appear in the Sherman Act. Nevertheless, the courts under that Act have had occasion to consider the question of restraints which did not affect the entire United States.[10] These decisions may be of some value in construing this particular phrase in the Clayton Act.

The original Section 7 contained the words "or tend to create a monopoly *of* any line of commerce." In the present law, the lan-

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[9] Senate Report No. 1775, 81st Congress, 2nd Sess., p. 5.

[10] *U. S.* v. *Columbia Steel Company* (1948), 334 U. S. 495; *U. S.* v. *Yellow Cab Company*, 332 U. S. 218.

guage is "*in* any line of commerce," and the phrase is made applicable both to substantial lessening of competition and to tendency to create a monopoly.

In *Van Camp and Sons Company* v. *American Can Company*,[11] the court considered the phrase "in any line of commerce" as it appeared in Section 2 of the Clayton Act, which section prohibited certain discriminations in price, the effect of which may be to substantially lessen competition or tend to create a monopoly in any line of commerce. The court said:

> "The phrase is comprehensive and means if the forbidden effect or tendency is produced in *one* out of *all* the various lines of commerce, the words 'in any line of commerce' literally are satisfied."

The court rejected the argument that the words must be confined to the particular line of commerce in which the seller (discriminator) is engaged and held that it applied also to the line of commerce in which the purchasers were engaged.

On that subject, the Senate Judiciary Committee report says:

> "It is intended that acquisitions which substantially lessen competition, as well as those which tend to create a monopoly, will be unlawful if they have the specified effect in any line of commerce, whether or not that line of commerce is a large part of the business of any of the corporations involved in the acquisition." [12]

The following is from the House Committee report:

> "The test of substantial lessening of competition or tending to create a monopoly is not intended to be applicable only where the specified effect may appear on a Nation-wide or industry-wide scale. The purpose of the bill is to protect competition in each line of commerce in each section of the country." [13]

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11 278 U S. 245 (1929).

12 Senate Report No. 1775, 81st Congress, 2nd Sess., p. 5.

13 House of Representatives Report No. 1191, 81st Congress, 1st Sess., p. 8.

Line of commerce is sometimes defined as the manufacture or distribution of a product distinct from all other products. The difficulty is, however, that many products may differ from other products and yet not be distinct so far as competitive effect is concerned. On the other hand, two products may fall in the same general category, yet may not fill the needs of the same class of buyers and therefore are not really competitive. For example, under the particular facts in *United States* v. *Columbia Steel Corporation,*[14] seamless high pressure steel pipe was regarded as not competing with welded low pressure steel pipe. In *International Shoe Company* v. *F. T. C.*,[15] it appeared that two types of shoes were primarily sold in different markets and to different classes of buyers with the result that in respect to 95% of the business, there was no real competition between the acquiring and the acquired corporations. Therefore, there was not substantial competition between the two companies.

Another important question has to do with the tests by which the illegality of the proposed acquisition is to be determined. In this matter, too, the Committee reports suggest some general standards.

The House report points out that the amendment is not intended as a mere duplication of the Sherman Act. Speaking of the cumulative effect of acquisitions, the report says:

> "The bill is intended to permit intervention in such a cumulative process when the effect of an acquisition may be a significant reduction in the vigor of competition, even though this effect may not be so far-reaching as to amount to a combination in restraint of trade, create a monopoly, or constitute an attempt to monopolize. Such an effect may arise in various ways: such as elimination in whole or in material part of the competitive activity of an enterprise which has been a substantial factor in competition, increase in the relative size of the enterprise making the acquisition to such a point that its advantage over its competitors threatens to be decisive, undue reduction in the number of competing enterprises, or establishment of relationships between buyers and sellers which deprive their rivals of a fair chance to compete." [16]

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[14] See Note 10.

[15] 280 U. S. 291 (1930).

[16] See Note 13.

The Senate report contains the following language:

"The Committee wish to make it clear that the bill is not intended to revert to the Sherman Act test. The intent here, as in other parts of the Clayton Act, is to cope with monopolistic tendencies in their incipiency and well before they have obtained such effects as would justify a Sherman Act proceeding." [17]

Speaking more specifically on the two tests of illegality provided in the Act,—that is substantial lessening of competition or tendency to create a monopoly, the House Committee said:

"These two tests of illegality are intended to be similar to those which the courts have applied in interpreting the same language as used in other sections of the Clayton Act."

It should be noted that the tests are to be *similar,* not necessarily the *same*. I think it was intended that proper consideration be given to the difference in purpose and application of the several sections of the Clayton Act. Proof of the probability of substantially lessening competition or tendency to create a monopoly is required under Section 2(a) having to do with price discrimination. It is also required under Section 3 having to do with exclusive dealing contracts. Yet there are important differences in the application of the law in Section 2(a) itself.[18] Similarly, there is a difference under Section 3 between tying contracts and "requirements" contracts.[19] In like manner, there is a difference between Sections 2(a), 3, and 7. Hasty generalizations should not be drawn that the manner of applying the tests under a particular set of facts under one section should automatically be adopted in cases under another section.

In the matter of *Pillsbury Mills, Inc.,* Docket 6000, the Federal Trade Commission pointed out that the "substantiality doctrine" of the *Standard Oil Company of California* v. *U. S.* and of *International Salt Company* v. *U. S.,*[20] as there applied in Section 3 cases, was not in itself a reliable guide for the Commission in carrying out

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[17] Senate Report No. 1775, 81st Congress, 2nd Sess., p. 4.

[18] See 1948 Policy Statement of the Federal Trade Commission.

[19] See discussion of this subject in *International Salt Company* v. *U. S.* (1947), 332 U. S. 392, and *Standard Oil Company of California* v. *U. S.* (1949), 337 U. S. 293.

[20] 337 U. S. 293 (1949) and 332 U. S. 392 (1947).

its long-range responsibility under Section 7. The rule laid down in Pillsbury Mills was that the Commission would make a "case-by-case examination of all relevant factors in order to ascertain the probable economic consequences."

In amending Section 7, Congress did not prohibit all mergers nor did it single out any particular types. It directed that mergers should be prevented where the effect may be to substantially lessen competition or to tend to create a monopoly. How better may the Federal Trade Commission obey this mandate than by examining all competent evidence which has a tendency to prove or disprove that the forbidden results are reasonably probable?

Both Committee reports give some attention to the words "may be" found both in the old and new versions of Sections 7. The Senate report explained that:

> "The use of these words means that the bill, if enacted, would not apply to the mere possibility but only to the reasonable probability of the prescribed effect, as determined by the Commission in accord with the Administrative Procedure Act. * * * The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipiency and before they develop into full fledged restraints violative of the Sherman Act. A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints." [21]

The attempt to reach evils reasonably probable in the future rather than those actually existing is one of the important differences between the Clayton and Sherman Acts. Its practical application in concrete cases often poses a difficult problem. A judge, considering the issuance of an injunction for threatened harm, or determining the amount of present damages to be awarded for injuries which may extend into the future, is confronted with a somewhat similar problem. In deciding this issue, Congress did not intend that the Commission should enter into the realm of speculation or conjecture. While future evils need only appear reasonably probable, nevertheless, in every case that reasonable probability must be proved.

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[21] Senate Report No. 1775, 81st Congress, 2nd Sess., p. 6.

In construing any statute, attention must be given not only to actual language but also to the overall purpose of the legislation,—the evils sought to be remedied, the results desired to be secured. It is generally said that the adoption of Section 7 in 1914 was to cure the evils of economic concentration and control, growing out of the operation of holding companies. The intention in adopting the 1950 amendments was to prevent the substantial lessening of competition by the acquisition of either the stock or assets of a competing corporation. This is illustrated by the economic data considered by both the House and Senate Committees, a summary of which is set out in each report.

It has often been pointed out that our various antimonopoly laws are vague and conflicting, and, in fact, sometimes seem headed in different directions. Nevertheless, they all are the product of a common aspiration,—the maintenance of the competitive system. Among all the nations, we have placed the greatest emphasis on competition. It is the cornerstone of our economic structure. This must be kept constantly in mind by all, who have any responsibility in regard to Section 7.

We must also keep in mind that the conditions under which the competitive battle is now waged differ from those existing in 1890 or in 1914. Scientific discoveries, technological advances, mass production and distribution, enactment of laws outside the antimonopoly field, a different standard of living, changed social concepts,—all have their effect on the production and distribution which go to make up commerce. Competition is still essential but it is competition under different rules.

The conclusion of the Congress was that mergers, however brought about, which may substantially lessen competition contained a threat to our economic system. The amendments adopted, together with the general legislative history, indicate that Congress meant to deal with this problem effectively. Attention was given to the inadequacies of the existing law and attempts were made to remove them. That the final result was a weapon more potent than anything theretofore designed seems obvious. The end result, whether good, bad, or insignificant, will depend largely upon the skill, the judgment and the common sense of the bar, the agencies, and the courts, whose duty it will be to wield this weapon in the public interest.

INCIPIENCY, MERGERS AND THE SIZE QUESTION: Section 7 of the Clayton Act

by

WARD S. BOWMAN, JR.*

Section 7 of the Clayton Act as amended in 1950 is popularly cited as the anti-merger law which patched the asset loophole, making acquisition of assets equally illegal with the acquisition of stock when competition may be lessened. I shall not concern myself with the patch. Here is an Act which attempts to deal specifically with an antitrust problem which is and has been dealt with under Section 2 of the Sherman Act—the problem of relative bigness. Useful speculation about the possible meaning of the new Section 7, I think, must be made not only in terms of the Clayton Act prior to amendment, but also in the light of the basic antitrust law, the Sherman Act, its changing interpretation by the courts, and particularly the problems it leaves unsolved regarding industries composed of a few big firms.

One of the key Sherman Act cases which dealt with a big single company combination was the old *Standard Oil* case. The result was the dissolution of the Standard Oil Company. Dissolution resulted not because Standard obtained so dominant a part of the market, or even because it did so by buying up competitors. According to the Supreme Court an aggregation of 75 percent of the market only created a presumption of illegality. This presumption was found to be conclusive by conduct such as railroad rebating, threats to competitors and discrimination. Performance was controlling.

Critics pointed to the fact that here was a rule allowing "nice" legal monopolies as contrasted to "nasty" illegal monopolies. Supporters of the decision hailed a rule of reason. But more recently, after Judge Hand's decision in the *Aluminum Co.* case, attention has been found focused on market power. A power concept is particularly relevant for companies obtaining very high proportions of sales in the markets in which they sell. Thus, in the *Alcoa* case, where performance was said to be immaterial, the Aluminum Company had 90 percent of the business.

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Considerable controversy in the field of antitrust revolves around the "bigness" question. It is an issue being considered by a national committee of lawyers and economists appointed to study antitrust policy.

Both the original Section 7 in 1914 and Section 7 as amended in 1950 were attempts to strengthen the law against relative bigness. The method proposed was to curb mergers leading to monopoly. The hope was to stop monopoly in its incipiency. Anti-merger legislation was thought to be needed by advocates of a strong antitrust policy for two principal reasons: (1) the difficulties involved in establishing the illegality of monopoly or monopolizing under the Sherman Act; and (2) the extreme reluctance of courts to recommend effective remedy when monopoly was found. Divestiture, as a relief measure, is sparingly used by courts, and legislatures are reluctant to criticize. It is difficult to restore past combined properties to their original status because of intervening changes, improvements and rearrangements of facilities; there is thought to be danger in tinkering with complicated industrial machines; there is likely to be solicitude for innocent investors in the monopoly property; there is the argument that prohibitions of unfair methods or specific bad practices will neutralize monopoly power; and finally there is always that basic question about the big company being more efficient.

Economists differ as to the importance of performance tests, and the effectiveness of outlawing particular practices, especially when few sellers are involved. Practically all, however, recognize the relevance of possible economies of large size. Here is the major economic rationale for rules which do not allow any power over price when jointly arranged by separate companies, but which condemn such power in single firms only when something approaching 90 percent of the market is achieved. There can be little doubt, I think, that the purpose of the new Section 7 is very substantially to lower this upper limit for firms attempting to expand by merger. Both the Federal Trade Commission and the Department of Justice are interpreting the Act in this way. The prima facie case held by the Commission to be made out in the Pillsbury expansion involves 45 percent in a narrow market—biscuit mix. And the "opinion" of the Attorney General in the proposed merger of two steel firms involves a considerably smaller percentage—about 20, even when another firm in that industry is larger.

The language of the original Section 7 of the Clayton Act seemed to be aimed at any horizontal merging (if the stock-asset question is set aside) for it forbade any acquisition where the effect was substantially to lessen competition—not competition in general, in the industry or in the relevant market, but competition between the acquiring and the acquired. There is nothing about relative size of the units or any suggestion about the possibility of even being able to rebut a presumption of illegality. Here seemed to be an indication of a clear standard, per se in nature and easier to spot than any of the activity by loose associations—such as price fixing, division of territory or joint boycotting, all of which have come to be considered per se illegal under Section 1 of the Sherman Act.

The courts permitted no such literal interpretation of Section 7. They decided that competition was competition in an entire industry, interpreted "*may*" as "*probably will*" and construed "*substantially*" in accordance with the same standards as were applied in Section 2 cases under the Sherman Act. In one case, *U. S.* v. *Republic Steel Corp.* (11 F. Supp. 616 (1923)), a court explicitly stated it was applying the Sherman Act test.

In the *International Shoe* case (280 U. S. 291 (1930)), the Supreme Court held that if a decision of a board of directors was a reasonable one in view of the interests of the corporation, and there was no other purchaser, and where there was doubt as to the continued profitable operation of the firm to be acquired, then a sale could take place to a competitor. Here the companies did make somewhat different kinds of shoes so it is possible that the case turned in no small part on the differences in the companies' products and where they were sold. Principally, however, the failing status of the acquired company appears to have impressed the court. In any event, the Federal Trade Commission had found a lessening of competition, had been sustained by the Court of Appeals but was overruled by the Supreme Court. The effect on competition was not substantial enough.

The sponsors of the Celler amendment cited this case with approval. They did *not* seek to make mergers illegal per se. Strong opposition had been expressed against making all mergers illegal—especially small local companies or failing companies.

The rallying cry for support for amendment to Section 7 was, of course, the asset loophole. Here was so obvious an escape from

prohibition of even the largest mergers that Section 7 had practically become a dead law. It would be difficult to disagree that if there were to be any kind of an effective statute attempting to stop mergers in their incipiency, assets as well as stock acquisitions would have to be included.

Sponsors of the new Section 7, however, were not so naive as to be unaware of the fact that amending Section 7 with respect to this point alone would involve little more than a legislative declaration of faith in the Sherman Act.

A problem, then, was how to have a law which would stop mergers in their incipiency before companies reached that size at which the force of the Sherman Act became applicable. Specifically, the amendment was aiming at something between a "per se rule" on the one hand which would make all mergers illegal, and on the other one which would make for illegality before a single concern had reached 64 to 90 percent of the market—the much quoted percentages of the *Alcoa* decision. In economic terms sponsors seemed to be concerned with the oligopoly problem—industries with few sellers.

A range of market control, the extremes of which might extend from 5 or 10 percent at one extreme to 90 percent at the other, probably includes most of the industrial and commercial activity of the United States—especially when the relevant market is a section of the country and the product is narrowly defined; as they are under either the Sherman Act or the amended Section 7. Somewhere within these broad limits Section 7 operates.

What has happened by the amendment of Section 7 is that the Federal Trade Commission, along with the Department of Justice, has been assigned a wide latitude within which to operate, subject, of course, to eventual approval by the courts. What the courts get depends on the administrative agencies. Initially what the agencies do is important. Deciding what mergers to stop is going to be no simple task in view of the extremely general nature of the legislative mandate. The task is further complicated by the use of phrases which elsewhere in antitrust law have come to be interpreted differently. The interpretation of Section 3 of the Clayton Act in the *Standard Oil Company of California* case* is not to be used as

* Here, Sherman Act tests were not followed.

precedent here according to reported statements by the Federal Trade Commission. Does the Department of Justice agree? Would the court be likely to allow a "price-fixing" type standard to be applied to a merger situation even if the Justice Department or Federal Trade Commission were to attempt it?

Because the Federal Trade Commission has indicated that amended Section 7 deals with problems different in nature from those covered by other sections of the Clayton Act, or other antitrust statutes, neither the standards of the Sherman Act nor the standards of other sections of the Clayton Act are applicable. Rather it is said (I quote CCH) "the commission will consider the objective of the Section as indicating, in a broad sense, the standards to be applied on a case-by-case basis."

An increasing number of members of the antitrust bar interpret this kind of language as "Dial E for Economist." But an incipiency hypothesis, which is Section 7, requires something that economists have not achieved an enviable reputation for—the ability to predict. Neither is mind-reading one of their fortes.

If the bar knew what standards were to be applied it might not require economists; and if the economists could convince legislatures that they knew what standards should be applied these could have been written into the Act; and if the Commission knew what standards it was going to apply it wouldn't have to resort to such "all things to all men" language as "case-by-case" analysis.

If one pushes this "case-by-case" business far enough, as Professor Jewkes pointed out in *Ordeal by Planning,* there comes a point at which to argue each case on its merits really amounts to not arguing the case at all. If, for example, the merger of some relatively unimportant industry is under review and the pros and cons seem to be fairly equally balanced, it will always seem unrealistic or "theoretical" to raise issues of over-all allocation of the nation's resources or the other merits of a market structure compatible with competitive determination of prices.

The method described for case-by-case study is not illuminating. The Commission's position is that case-by-case analysis would begin with the *relevant* facts concerning the competitive pattern of the industry as a whole and its markets, particularly in the period preceding the acquisition. From such facts the Commission will expect to be able to determine what changes the acquisition can be expected

to make in the character of the competition in the market concerned.

It will take more than an economic analysis to find any activity or structure that isn't consistent with a literal interpretation of that statement. Still something is going to happen. What is feasible? Is performance or industry structure likely to be more relevant in studying a case?

Performance testing is a method which has often been recommended by those who think there is as much danger from too much competition as from too little. It has become a slogan for those who fear the dangers of straight-jacketing industry by any unequivocal prohibitions or uniform general rules, and who specifically dislike any concepts calling for per se or presumptively illegal market status or behavior. Some like to call this the rule of reason approach. In an extreme form this would call for reviewing the effects of everything—even price-fixing agreements. Performance tests seek conclusions as to whether, for example, profits are too high, whether innovation is rapid enough, whether production is in the right size firms, whether there is an efficient adjustment of capacity to output, whether there is a proper avoidance of waste in selling activities, whether new firms have entered or can enter the industry readily, whether or not the restrictive agreements themselves contain the seeds of their own destruction, whether or not equality of bargaining power is achieved with either or both suppliers or customers, and as many more criteria as any bright analyst can invent. All of these sum up to a general evaluation of performance to tell whether the public is being adequately served.

These performance criteria may raise more problems than they solve. Economists are no better than lawyers at measuring with uncalibrated rulers.

An example may clarify the difficulties of applying such tests to a Section 7 problem. Suppose, for example, the Commission found a performance record something as follows: A firm has grown from 10 percent of its market to 15 percent by three successive mergers and now proposes to merge with another company to reach 20 percent. There are 20 other firms in the market no one of which has over 5 percent. No new firms have entered the industry in 10 years. The firms all show profit, but the largest firm has one of the best earnings records.

Suppose further the firms in the industry have had a strong trade association which along with most of the industry members have twice been convicted of price fixing. In addition, the small firm, which is being merged with the largest, has just acquired a very profitable patent which it has not licensed to others. Moreover, suppose that the largest company owns 50 percent of an essential raw material, all of which is used in the industry under review.

Who can say, and for what reason, that any or all of these factors will work for relatively more or less competition because of the one acquisition. If every one of them were absent, the direction of the effect of the merger seems no less probable nor less substantial. There is an exception, however, a criterion which does shed light on possible future structure. That is the history of entry. It goes to the problem of whether the fewness of firms caused by merger can be expected to be dissipated by new companies entering the business. A record of frequent and successful entry into an industry would make a conclusion of substantially lessened competition very unlikely. (This is so, even though an absence of entry might not prove otherwise.)

The harder question about merger and substantially lessening competition involves the precedent established in an industry of allowing a firm to achieve as much as, for example, 20 percent of the market. It will be difficult, if not impossible, to show that a 100 firm industry which becomes an 81 firm industry is substantially less competitive, even if one firm achieves 20 percent of the relevant market. There are, still, 80 other competitors. But if that one is allowed 20 percent and, on this precedent, the others merge so there will be only five firms, there is probably no one in the country who would say that the result is as competitive as with the original 100, or with 50 or with 20 or with 10, and substantially so. On what grounds can F. T. C. approve the first without setting the stage for this result? No case-by-case analysis is likely to shed much light on whether this result *may* or *possibly will* or *probably will* happen. It seems reasonable to expect that an administrative agency taking its job seriously will attempt to stop such mergers. Three "ifs" must be mentioned. The first of these is a requirement of the Act. The second and third relate to economic evidence deserving consideration: If financial difficulties or impending insolvency threatens, the doctrine of the *International Shoe* case seems applicable—especially when differences

of product and markets between the acquiring and the acquired can be shown. And the lower the market percentage of the newly combined companies, the better the case for merger. The recent mergers of Nash and Hudson, and of Packard and Studebaker are consistent with such a determination. Second, as has been mentioned, if there has been frequent entry of new firms—successful new firms—there is not likelihood that a merger will have the effect of decreasing the number of firms in the industry for a long enough time to have any substantial effect on the structure of the industry. And third, if it can be shown that the merger proposed is directly related to economies of scale there is greater expectation of approval. Here is a point which is relevant but extremely difficult to establish.

Economists don't know very much about efficiency. Neither do the lawyers—in or out of government. And case-by-case study is not likely to reveal convincing evidence here either. Nor is much help to be expected from engineers. Input output measurement is relevant to plant operation, but is apt to be irrelevant to the merger case where interplant economies are pertinent. Past mistakes as to plant scale cannot be corrected by merger. Interplant economies are such that management is likely to be better informed than others. But testimony from management will not be viewed as impartial.

All this suggests that any conclusion about the efficiency to be achieved from a proposed merger will be most difficult.

Because of the fact that the recent automobile company mergers have not been questioned, some might have concluded that mergers in an industry are permissible if the combined companies do not reach or exceed the size of a still larger firm in the industry. A recent merger proposal involving Bethlehem and Youngstown Sheet and Tube in the steel industry casts considerable doubt on this proposition.

Attorney General Brownell announced that the Department of Justice considered this proposed merger in violation of Section 7. After this announcement the President of Youngstown Sheet and Tube was quoted as saying he was considering taking the matter to the courts. He went on to point out that he was sure Bethlehem and Youngstown when joined together would make for more vigorous competition, not less vigorous competition, in the steel industry. The Justice Department obviously doesn't agree. The Department apparently looks with some apprehension upon what it may well view as setting the stage for a three-firm steel industry.

Here is an ideal case for eventual submission to the Supreme Court. A few short sentences from it would be more useful to the bar than volumes of exposition by the best analysts—economic or otherwise.

If there is not economic justification for the proposed steel merger, there would seem to be even less economic justification for the existence of U. S. Steel in its present size. Disallowing the merger sets up what may be called a double standard based on historical accident. On the other hand, any industry which moves from 10 or 20 to 2 or 3 companies may well be susbtantially less competitive than before, and this is true of an industry containing one large company and a number of smaller ones. But the existence of the large company is relevant in terms of probable effects. There is less reason to believe that competition will be affected substantially by the merger when a large company exists. The most important source of economic power is left untouched.

These speculations, which I have imposed upon you, relate to horizontal mergers. The Act, of course, is not so limited. Vertical mergers, as well as conglomerate mergers are also included. Their effect on competition is much more speculative—I would go so far as to say "economically irrelevant" except as a means of achieving some substantial power at one level, which is horizontal power. One gets the impression that something more than this may have been intended. I have no idea exactly what this is or how it might be established; perhaps on the Government's theory in the *DuPont-G. M.* case.

Whether or not the courts accept the kind of an interpretation of the new Section 7 which would make for illegality of combinations of some 20 percent of the market, or even less, depends upon how strictly they interpret the phrase "may tend substantially." Setting a high standard so as to require positive evidence that an industry will behave substantially less competitively with one fewer firm, regardless of how few firms the industry contains, will impose a burden on the agencies which they will find difficult or impossible to meet. This was how Mr. Justice Burton saw the titanium industry in the *National Lead* case, a Sherman Act case. He said in effect that there was no reason to believe that four firms would act any more competitively than two. If, on the other hand, the courts interpret "may tend" as not confined to exactly what the merger under review will

do but rather to what is likely to happen if other members are allowed to do the same, then a great many mergers may be stopped, including possibly the steel merger, where a considerably larger company exists. Such a determination would be consistent with more rigorous standards than Section 2 of the Sherman Act while avoiding the interpretation (as in the *Standard Oil Co. of California* case) of Section 3 of the Clayton Act.

THE NEW SECTION 7

by

MARK S. MASSEL*

The new Section 7 of the Clayton Act was passed in the midst of a great debate. Before passage, there were many arguments about the need for changing the Section, and the influences of mergers, consolidations, and corporate acquisitions on the state of competition. Since the passage of the Act, the debate has continued unabated. In fact, the recent wave of mergers has even led to the question—somewhat disingenuous—did the new Act encourage more mergers?

However much one may enjoy these debates, we as lawyers must face a practical problem: what can be done to make the Section administratively practicable? For this purpose a preoccupation with the desirability of the Section hardly contributes to progress; we must accept the Section as an established national policy which must be administered by the courts, the administrative agencies, and the bar. Therefore, we shall confine our discussion this afternoon to several practical problems in the administrative development of the Section.

Unfortunate Draftsmanship

In examining these administrative problems one must recognize that the Section is poorly drafted. Several articles have been published examining the specific phraseology of the Act and exposing the inadequacies of its draftsmanship. There is no time here for reviewing these criticisms.

To illustrate the inadequacies let me point out one feature. The New Section 7 retains the old phrases "to susbtantially lessen competition" and "tend to create a monopoly." The only change made was to correct the grammar of the first clause changing it to "substantially to lessen competition."

These same phrases are contained in Section 3 of the Act. Nevertheless, Congress apparently did not intend to require that the standards for judging a violation of Section 7 should be the same as the standards developed under Section 3. Therefore, we have seen Federal Trade Commission Chairman Howrey wrestling with

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the parallel phrases in order to establish a distinction—without a difference in language—between the two sections in his opinion in the Matter of Pillsbury Mills.

Because of the verbal vagueness of Section 7 its future interpretation awaits development through construction and application over a period of time. The new Section 7 appears to be a general charter of broad policy. Its specific content and application will depend on substantial case-by-case development.

In that development, several groups will have to play important roles: the administrative agencies, the courts and the lawyers for both plaintiffs and defendants. In that development the role of the bar is as important as any.

Role of the Bar

It has become fashionable in many circles to blame the Federal Trade Commission or the Antitrust Division or the courts—or, indeed, all three—for "unfortunate" and "illogical" developments in the antitrust law. However, this easy criticism of the shortcomings of the administrative agencies and of the courts overlooks an elemental fact—the bar itself plays a powerful part in the development of the law. Before a court interprets the intent and application of an antitrust statute, it has been exposed to the evidence and arguments presented by counsel for the defendant as well as by the complainant. The same exposure affects hearing officers and government commissions. Therefore, misinterpretations and misapplications in the development of a new antitrust statute are not wholly independent of the work done by the bar.

In the antitrust field, the bar must carry the responsibility of testing and probing the efforts of counsel for the administrative agencies. Without the participation of the private bar, administrative agencies might tend to develop capricious or over-zealous rules. Without the affirmative arguments of the private bar, administrative agencies and the courts might well make rapid progress in developing mechanical *per se* rules because such rules simplify their administrative problems.

In its role of testing and probing, the bar must challenge many of the simple assumptions which might be made in Section 7 proceedings. For example, the mere acquisition of a competitor's assets can be assumed to lessen competition. Without challenge, there is room

for a mechanistic assumption that the only purpose in acquiring the assets of another company is to reduce competition. A court which has been given no demonstration of the possibility that a specific acquisition will promote competition can easily accept such an assumption without question.

In these challenges the bar must learn how to utilize economic analysis more effectively. Such analysis must be used to test the significance of circumstantial evidence and of the conclusions drawn from it. Unless the defense presents economic data and affirmative interpretations of the plaintiff's evidence, many cases will be decided upon a flimsy showing. If government agencies show superior ability in handling economic data in Section 7 cases, it seems to me that the interpretations of the law may well follow the *per se* trends of Section 3 and that the basic purposes of the new Section 7 may be lost in the name of administrative and judicial convenience.

The bar must play its part in developing criteria regarding the substantive rules and the handling of evidence in order to bring economic analysis to bear on the new Section 7 cases. Without a firm understanding of what are the significant factors in these cases, a court can easily assume that competition has been lessened substantially on the basis of the only affirmative evidence and arguments presented, no matter how flimsy they may be.

Role of Administrative Agencies and Courts

In line with this role, the bar should undertake the persuasion of administrative agencies and of courts to spell out complete and clear opinions in the new development of Section 7. For it is only through clearly-stated opinions that we can develop perceptive guideposts. Without such guides, none of the three parties involved can function effectively. The bar will face impossible tasks in advising clients and in preparing cases. The administrative agencies will have difficulty in applying public policy to specific conditions. And the courts will have to assume the burden of developing completely new theories without the help of broad, substantial discussion of the problems which should be considered.

The roles of the Federal Trade Commission, the Antitrust Division, and the courts parallel the role of the bar. First, there is the specific need for coordinating the policies of the Federal Trade Commission, the Department of Justice, and the courts. This need is il-

lustrated by the application of Section 3. In the Standard Stations Case the Supreme Court felt that it does not require an examination of economic effects under Section 3 of the Clayton Act. However, the Federal Trade Commission has indicated that it will inquire into the economic effects under the same Section 3. This difference can, of course, complicate the application of Section 3 in private suits and in Federal Trade Commission prosecutions. Unfortunately, Section 7 provides ample opportunity for the same complication.

The need for clear opinions from the administrative agencies cannot be overemphasized. The F. T. C. has indicated that it recognizes the importance of constructive discussion in its opinions and the shortcomings of its past predilection for stating succinct opinions in statutory language. However, it needs considerable support and stimulation from the bar if it is to change its habits. Further, the F. T. C. should be encouraged to state fully its reasons for clearing acquisitions as well as its reasons for objecting to them.

We might well cast about for a practicable basis for the publication of informal opinions by both the F. T. C. and the Antitrust Division, explaining the bases of the acquisitions they have cleared. In the early stages of development of Section 7, such a custom would help everyone to understand the law. It is true that such informal opinions would make it somewhat more troublesome to "clear" an acquisition. However, their benefits would seem to outweigh the disadvantages. Further, if they were published informally—possibly in periodic progress reports without mention of the names of the companies involved—they would not create any pressure against informal clearances.

As a minimum, such opinions would help the agencies to apply the new Section 7 on a consistent basis. With the substantial number of such acquisitions, each agency must guard against conclusions which are strongly influenced by the personal predilections of the individuals who consider the case. It is clearly in the interest of the agencies, the acquiring companies and the public that the Section be administered without discrimination—indeed, without the perfectly honest discrimination which stems from differences in the attitudes of the several officials involved in these cases in each agency.

The peculiar consequences of Section 7 indicate a need for an accelerated pace in carrying out action. After a company has acquired the assets of another, the process of unwinding the transaction may

be extremely difficult. A decree that the assets shall be returned to the sellers or disposed of in some other way can develop substantial injustice. In most instances requiring former shareholders to take back their assets several years after the sale would cause considerable hardship. Therefore, it does not seem likely that they could be compelled to do so. Similarly, it may become almost impossible for a company which has thoroughly integrated the assets of another with its own to divest itself completely of the acquired assets without weakening its own competitive position.

Need for Economic Analysis

The more significant requirement in the administration of Section 7 is the development of criteria for economic analysis. The statute contains a number of key phrases which can be interpreted only in terms of economic effect. Such phrases as "substantially to lessen competition," "tend to create a monopoly," "in any section of the country," all connote the interpretation of economic effects. Without such interpretation the statute could be read into meaningless obscurity or into a flat fiat against all mergers, consolidations and acquisitions.

Because of limitations of time and space, we shall consider here only certain aspects of three major areas of economic analysis; First, the background of the market; second, the effect of the acquisition on competition in the market; and third, the problems of evidence which are created by economic analysis. This discussion is presented only to illustrate the strategic importance of economic analysis. It does not purport to be an attempt to describe the field completely.

I. Background of the Market or the Industry

To determine whether competition has been lessened or a tendency to create a monopoly has developed, the economic examination usually starts with the setting of the market within which the selling and acquiring companies operated. This examination includes several major economic factors.

A. What market is affected?

If the acquisition involves vertical integration, which market should be examined—the market of the selling company, or the market of the acquiring company? For example, if a paper mill acquires a pulp mill, which market is the more significant? It may be argued,

in certain instances, that both markets should be considered. However, even if both are reviewed, the economic analysis might cover the two as separate markets.

Determining what market is affected frequently requires consideration of what products are in competition. Thus, on the one hand, one may argue that wall board is in competition with all types of wall and beaver board, all types of plaster, veneers, plywood, sheet paneling and lumber; on the other hand, one might argue that because of the popularity of a given brand of wall board, no other products are in competition with it. Hence, the question of the substitutability of other products becomes important.

The definition of a market includes consideration of what levels of competition should be examined. The pattern of competition is not the same: between the manufacturers, of a given item, between wholesalers who carry it, and between retailers who sell it. Similarly, a manufacturer who produces an item for consumer use may or may not be competing with a plant which produces the same "product" for industrial or commercial use.

No definition of the market is complete without a determination of its geographical size. Thus, machine tools are usually sold on a national basis. A producer located in New England may sell his products all over the country in competition with other machine tool plants located in Ohio, Wisconsin, or other states. Contrariwise, the fluid milk industry operates on a regional basis. Fluid milk processors in Wisconsin are not in competition with the fluid milk processors in California. Therefore, the nature of the product, its manufacturing methods, its relative transportation costs, its distribution methods, and its uses affect the geographical nature and size of the market.

This question of geographic size is, of course, dependent on the particular market which is examined. For example, suppose a lumber manufacturer purchases a competing manufacturer which operates in the same geographical region: it might be argued, on the one hand, that the effect of the acquisition should be examined in the competitive national market for all types of lumber; conversely, it might be argued that since the two mills compete in the purchase of standing timber and of logs the effect of the acquisition on the regional timber and log markets should be examined.

Cutting across the geographical problem are the interrelations of regional and national markets. In many instances, competition among

the various levels of an industry—manufacturing, wholesaling, and retailing—is so interrelated that an examination of one level involves analysis of the others. Retail competition may take place on a restricted regional basis while manufacturers compete in a national market. In such a case, an examination may require an understanding of the relationships between the regional and the national markets.

B. Freedom of Entry

A market can rarely be understood without considering the ease or difficulty in breaking into the market. Thus, if new companies can readily get into the market, the effect of an acquisition would not be serious. On the other hand, if it is almost impossible for a new company to enter the market, the acquisition may have far-reaching effects on competition. Compare for example, the ease of establishing a new grocery store with the complex arrangements required in developing a new virgin aluminum plant.

Freedom of entry into the market calls for an understanding of the amount of capital required, the availability of the new capital, the type of technical know-how needed, the ease with which companies in related industries can move in, and the relationship of ease of entry to the use of substitute or competing products.

C. Technological Developments

The rapidity and importance of technological development is frequently a key factor in understanding the competitive pattern of a market. Thus, if there has been rapid development, an acquisition may reduce the extent and direction of the development. Conversely, if smaller companies have not been able to keep pace in a rapid development, a merger may produce a company which can keep pace in place of two companies that might have fallen by the wayside as separate operations.

D. Patent Position

The degree of competition in the market may be influenced by patent controls. Such a review would include a consideration of the importance of patent protection and the ease with which licenses may be obtained, together with such practices as cross licenses, or the use of patents to support other restrictions.

E. Declining or Expanding Industry

The influence of an acquisition may depend upon whether an industry is expanding or declining. If an industry is declining, and a number of companies are retiring from the market, a merger might be regarded as a step toward maintaining an additional company in the field. On the other hand, in an industry which is fast expanding with a number of new entries, it might be argued that a merger could not have a substantial effect.

F. Changes in the Structure of the Market

An economic analysis of a market frequently includes a review of developments, over a period of time, in the structure of the market. Changes in the number of competitors or potential competitors may be important indicators. The sizes of the competitors, together with the changes in the degree of concentration over a period of years, may be significant. For example, fifteen years ago there may have been two companies in the industry with 90% of the volume in the hands of Company A; the numbers may have increased each year since then, so that today there are fifty companies in the industry; the degree of concentration may have changed so that today no company accounts for more than 10% of the industry. Conversely, the industry may have had forty companies ten years ago and may be down to four companies today.

G. Changes in Products and Vertical Integration

The industry may be going through substantial changes in the nature of its products or in the nature of its production operations. Thus, the trend toward vertically integrated paper and pulp operations has been a strategic one in the development of both the paper and the pulp markets. Conceivably, the trend may continue to such a point that some day there may be no paper mills that do not have their own pulp sources. Conversely, in the early stages of the development of a new raw material, the original producer of the material may fabricate all the final products made with it. However, as time goes on, more and more of the fabrication may be turned over to companies who purchase the raw material.

H. Changes in Market Strategy

The competitive marketing relationships within an industry may change substantially over a period of time. Thus, there may be a

general shift from selling the product through specialty stores to selling it through many types of outlets. There may be a shift from selling exclusively to department stores to an emphasis on discount houses or to the syndicate stores.

I. Nature of Competition

Finally the description of a market usually requires a try at describing a rather elusive quality—the nature and degree of competition. Competitive advantages may be produced by long historical pressures or by the pressures of distributors and buyers. Again, because of a long history of cut-throat price competition or the fear of extreme competition, an industry may develop self-protection by tacitly avoiding tough competition. There are no easily defined gauges for measuring the nature and degree of competition, in either price or other terms. Similarly, tough competition does not always lead to low profits or frequent price changes. The general body of economic analysis has not produced any substantial criteria for determining the nature and the degree of competition. Therefore, the lawyer and the economist, faced with a Section 7 problem, may have to plow virgin territory in this area.

II. Effect of the Acquisition on Competition

After describing the background of the market or industry in which an acquisition has taken place, the next range of economic problems deals with the impact of the acquisition on competition within that market or industry. Within this second range of problems, the economic evidence centers on the specific companies involved rather than the general description of the market.

A. Market Position of Both Companies

One of the key factors in judging the effect of the acquisition is an examination of the position of two companies in the market. If neither company is a significant factor influencing competition, production, and pricing, the total of the two companies may not be very significant. In that event, the merger of the two may not have a serious influence on competition.

In this examination, emphasis is usually on the relative competitive advantages and disadvantages of each of the companies and of the two together. In some instances it may be possible to establish that the individual companies would not be able to continue in opera-

tion alone. However, the two companies fused together may be able to continue to maintain—and possibly to increase—competition in the market. For example, it has been contended by some that the merger of Hudson and Nash will permit them to continue to operate effectively within the automobile market, while one of the companies operating individually might not have survived; therefore, the merger has increased rather than diminished effective competition.

B. Previous Relations Between Companies

Another phase of this examination might cover the previous relations between the two companies. Thus competition may not be influenced by the acquisition because of previous relationships between the two companies. For example, if Company A were the sole customer of Company B, it might be argued that the merger would not influence the supply of Company B's product on the market. Similarly, suppose that Company A and Company B had operated in distinctly different regions and had never competed with each other; it might be argued that since the acquisition did not reduce competition between them, it could not reduce total competition in the market.

C. Injury to Others

A more specific inquiry relates to an examination of the injury—actual or potential—to competitors, buyers from or suppliers to the two companies. In this consideration, a specific review of the three groups of outsiders and of their relations to the two companies may disprove the assumption that competition was lessened.

D. Consideration of Alternatives

In general, the economic consideration of the effect of an acquisition on competition appears to relate to a consideration of alternatives. What would have happened to the seller if the assets had not been sold? What would have happened to the purchaser? Did the purchaser have other means of expanding? These considerations could cross almost every type of examination of the results of an acquisition. Thus, the contention about the merger of Hudson and Nash calls for a consideration of the probable alternatives: what would have happened in the automotive market if the companies had continued separately and what will probably happen after the merger.

In the consideration of these alternatives, economic evidence frequently calls for a distinction between the immediate and long-run

consequences of the acquisition. Thus, in some instances, the immediate consequences may appear to lessen competition. However, it may be possible to contend that, in the long-run, competition will be improved. Such an examination frequently calls for a consideration of the historical developments in the industry. There may have been other acquisitions which did not reduce competition. It may be possible to show that the changes in relative competitive positions, over a period of time, had been so great that mechanical assumptions about the result of the merger are misleading.

III. Evidence

The use of economic analysis in Section 7 cases relates, in the final analysis, to problems of evidence. An analysis which might satisfy the businessman or the economist has little practical value unless it can be presented in a form which persuades a court or an administrative agency.

A. Circumstantial Evidence

Basically, Section 7 cases rest upon circumstantial evidence. It is hard to visualize direct and conclusive evidence that an acquisition or a merger has lessened competition, increased competition or had no effect. It is hard to visualize specific and direct proof in this field.

Therefore, the evidentiary problems under Section 3 are based on the elements of a circumstantial evidence case. This means that the plaintiff's procedure is to develop the hypothesis that the merger or acquisition lessened competition; to show that the circumstantial evidence he presents is compatible with this thesis; and to show that the evidence is not compatible with any other theses. On the other hand, the defense follows several tacks: to challenge and disprove the specific evidence presented by the plaintiff; to show that the evidence presented by the plaintiff is not compatible with his thesis; to show that his evidence is logically compatible with another thesis; and to introduce further evidence to disprove the plaintiff's thesis, or to throw doubt on the contention that it is the only reasonable thesis.

B. Testing Hypothesis

Within this range of problems, one of the major burdens of economic evidence, as well as of the argument, is to test the assump-

tions that may be derived from the evidence which is presented. Frequently, a case is presented by the attorneys for the Federal Trade Commission or the Department of Justice, based upon tacit assumptions that an inescapable conclusion must be found from the evidence presented without specifically showing the relations between the evidence and the assumption. In such a case, the task of the lawyer may be to probe the assumptions, to develop basic challenges of the assumptions and to produce evidence which tends to overthrow the assumptions.

Because of the general nature of a circumstantial evidence case, economic analysis may be used not only to produce new evidence by way of rebuttal but also to examine the significance and consequences of evidence produced by the other side. In this connection it must be remembered that economics has not developed any practicable method of establishing specific conclusions such as are found in certain of the physical sciences. Thus, a series of historical findings may be subject to varying interpretations regarding trends. As we have seen in many of the presentations of economic data concerning wages and costs of living, using trends from 1930 to 1954 will produce interpretations which are quite different from the trends for the period 1945 to 1954. Indeed, there are practically no economic trends which follow a steady, logical progression over a long period of years.

In this setting, economic analysis may be extremely useful in testing the assumptions and conclusions presented by the other side.

One key to the use of economic evidence in defense or rebuttal is a clear economic analysis of the evidence presented by the other side. Through this analysis it might be possible to determine the weaker points and to produce evidence which challenges the opposition's hypothesis.

The use of economic analysis depends upon an understanding of this setting. Because of the peculiar characteristics of circumstantial evidence and of economic data and interpretations, economic evidence depends upon basic evaluations of the problem presented by the case. At times, a headlong rush into preparing and submitting evidence may weaken a sensible development of a Section 7 case. The use of the analysis may be much more fruitful in testing out an opponent's assumptions and developing ways and means for challenging them. There are many situations in which the best de-

fense relies mainly upon argumentation supported by a short pin-pointed presentation of carefully chosen evidence.

C. Selectivity of Evidence

The problem of selecting evidence is of more than ordinary importance in these cases. Without an evaluation of the entire nature of the case, a defendant may rush in with evidence which follows the general structure of the plaintiff's case—trying to disprove his evidence. However, the strongest economic evidence may call for the introduction of a completely new line of information which cuts across the plaintiff's assumptions.

In the specific application of economic evidence, the government's case may rest entirely upon the assumption that a given type of competition will be reduced as a result of the acquisition. Enough time may have elapsed between the acquisition and the trial to permit the introduction of specific information about what has taken place in the market. For example, it may be possible to show that since the acquisition a number of new companies have entered the market, or that since the acquisition the market percentage of the merged company is smaller than the totals of the two predecessor companies. Or that the concentration of volume in the hands of several large companies has been reduced.

D. Place of Opinion

In introducing affirmative evidence there seems to be an advantage in presenting specific information of what has happened—as current as possible—rather than relying on economic opinions. The general conclusion, even of a recognized economist, that competition has not been affected by a merger would probably have less probative weight than a specific showing of what has happened to volume, prices, entry into the market, and competitive maneuvering.

In this process, opinion has its place. However, it is frequently overemphasized. Thus, the lawyers conducting the argument can develop opinions. Similarly, use may be made of opinion by the presentation of an expert who may, on the basis of the evidence presented, show that the hypothesis has not been proven. An economist who testifies that he has studied a situation and feels that competition has not been lessened may not be very forceful; on the other hand, his opinion that the evidence presented by the other side does not show that competition has been lessened, may be quite effective,

particularly if it is linked up with an opinion that other evidence indicates no lessening of competition.

E. Statistical Data

One of the most difficult problems of evidence in the Section 7 case involves statistical interpretations. Most statistical data comes from such sources as the Bureau of the Census, the Bureau of Labor Statistics, and trade associations. Frequently such data is too general to support any clear presumptions about what has taken place in a market. For example, an examination of the effects of an acquisition of a manufacturer of a specific type of lathe would be difficult to develop because most regional and national figures cover only the machine tool industry or general types of machine tools. Because of the difficulty of developing specific figures which relate to a specific market, both sides are frequently hard put to establish their case. However, the side that produces a tremendous amount of statistical data is always better off if the other side does not challenge the significance of the data presented.

The problem of finding specific data is complicated by the difficulty of making a survey of an individual situation. To begin with, specific surveys are extremely difficult to design. Frequently, what appears to be a well-designed survey may be subject to severe attack because it does not meet .the specific issues which may be drawn from a case. Secondly, such specific surveys frequently entail a prohibitive cost. Thirdly, many types of specific data are not easily available because companies, which produce a number of products, frequently do not themselves maintain specific information covering each separate product. Many companies are hesitant to furnish such data for fear that their competition may learn too much about their business.

In this connection, one of the problems in developing special studies is how to use confidential information. Many companies will divulge valuable information on condition that the data will be kept confidential. Such surveys may provide clews to usable evidence. However, they could hardly be introduced by either side without upsetting the confidentiality of the information. For example, if the Federal Trade Commission should develop a confidential industry survey and attempt to introduce the results of that survey through the testimony of its economists, a respondent would reasonably

challenge the introduction of that evidence unless he has an opportunity to review the evidence regarding the individual companies covered by the survey in such detail that he can cross-examine or counteract the impression developed from the evidence. For without understanding the evidence of individual companies covered in the survey, the respondent could hardly develop a sufficient understanding of the evidence to challenge or to counteract it.

F. Use of Economists

Cutting across the evidentiary problem in the Section 7 case, is the appropriate use of the assistance furnished by economists. In general, the bar has not developed satisfactory techniques for appropriate use of economists. A broad review of antitrust cases seems to indicate that the government has devoted more attention and has had more success in the use of economists than have private litigants. One of the major contributions that the bar can make to a constructive development of Section 7 would, it seems to me, call for further and more constructive use of economists.

The mechanical use of economists is usually not effective. Without an examination and understanding of the issues involved in the individual case, economic evidence and economic opinion may have little significance.

Frequently, the most significant contribution which can be made by an economist is to provide overall advice on the strategy of the case. Such advice may not call for his appearance as a witness. He may be much more useful in determining the weaknesses of the other side and in developing the bases for challenging the hypothesis. He may be much more useful in determining the types of evidence which can be presented by operating men working for the company, for suppliers, for customers, and even for competitors. Similarly, his most strategic value might involve the development of a cross-examination of the witnesses for the other side.

In some instances, an economist may be useful mainly because he can point out the weaknesses of a lawyer's case. A construction of circumstantial evidence in the hands of a lawyer who is not skilled in economic analysis may produce conclusions and assumptions which are easily upset. In this sense, an economist may be very useful by merely pointing out pitfalls.

In some instances, an economist may be used to plan and supervise special studies. Those studies may be presented by the economist or by the operating personnel. When they are presented by the economist, a general understanding between the lawyer and the economist regarding the presentation and significance of the data may be of utmost importance. Of course, in this presentation, the lawyer must consider not only the analytical ability of the economist but also his personal value as a witness.

At times opinion evidence from an economist may be useful. However, such opinion evidence calls for a rather critical examination by the lawyer and is much stronger when it is backed up by specific data.

INTRODUCTION TO MEETING ON COST JUSTIFICATION UNDER THE ROBINSON-PATMAN ACT

The setting for the problem of cost justification under the Robinson-Patman Act is found, of course, in the statute itself. The pertinent sections dealing with cost, Sections 2(a) and 2(b), contain so many other ideas that only a selective reading provides the cost section. Such a selective reading would be:

> Sec. 2(a) "It shall be unlawful . . . to discriminate in price . . . where the effect of such discrimination may be substantially to lessen competition . . . provided that nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered. . . ."
>
> Sec. 2(b) "Upon proof being made . . . that there has been discrimination . . . the burden of rebutting the prima-facie case thus made by showing justification shall be upon the person charged with a violation. . . ."

Congress seemed to believe that the cost defense was a simple, workable provision. However, the Federal Trade Commission, the courts and respondents have found that the art of cost accounting, especially in the area of distribution costs, does not enjoy enough precision to encourage workable administration. They have found that the only simplicity in the doctrine is to be found in the drafting. Similarly, the legal and accounting professions have found ease in saying, "Price Differences are justified if they are no greater than cost differences." But they have found profound difficulty in applying this reasonable rule to the facts of business life.

Just as Congress dismissed the difficult problems of administering the cost proviso, many business men and lawyers have tended to dismiss the possibility of ever establishing such cost justifications. I have a hunch that most discussions of the cost aspects of the Robinson-Patman Act have degenerated into "Hate the FTC" sessions. The FTC has been attacked as unreasonable and overly technical; cost justification has been attacked as impossible; and discussions of cost justification have been attacked as unduly theoretical and impractical.

In the light of this background, the most interesting aspects of today's discussion will, it seeems to me, be found in its implications. Such implications are: (a) that establishing cost justification is practical, though difficult; (b) that the FTC has, on the whole, been quite reasonable in its treatment of the cost defenses which have been presented to it; (c) that neither the Commission nor enlightened respondents have been too influenced by picayune or impossible tasks of proof; and (d) that there have been so few serious cost defenses that the law of cost justification has hardly had a chance to develop.

Another area of agreement in this afternoon's discussion seems to be the conclusion that cost accounting calls for reasonable approximations of cost differences rather than definite, inescapable, finite conclusions. This means that there is no point in wasting time looking for the preciseness (which may, at best, be superstition) which is associated with financial accounting. Because these cost approximations are necessarily based upon judgments about reasonable accounting methods, we must cast about for methods of testing and evaluating the reasonableness of these judgments.

It is for these reasons that the statements presented today have such unusual interest. To fully appreciate their significance we should take a quick look at the participants.

Corwin D. Edwards sketches in one phase of the economic background—a type of statistical evaluation of what has happened in the administration of the Robinson-Patman Act—to the problem of cost justification. He is unusually qualified. He was the chief economist of the FTC; he served with the Antitrust Division of the Department of Justice in addition to other government agencies. He was the U. S. representative on an *ad hoc* committee of the U. N. on restrictive business practices. He has taught in the field of anti-trust and governmental regulations in leading universities. At the present he is a Professor of Economics at the School of Business of the University of Chicago. He is well known for his book on *Maintaining Competition*. All in all, he is clearly one of the best qualified economists in the field.

Albert E. Sawyer covers the legal background of the cost proviso. He comes to the task with unusual ability. He has achieved wide recognition, not only as a lawyer but as an accountant specializing in cost accounting. His practice includes substantial work in the area of the Robinson-Patman Act and of the cost proviso. Indeed, many believe that he has had as much experience in this field as any prac-

ticing lawyer. His article on the subject in the *Iowa Law Review* is one of the leading articles in the field. He is the only lawyer on the Federal Trade Commission's supervisory committee on cost justification.

The accounting features of the problem are handled by Herbert F. Taggart who has a position of unusual interest in the field: he is the chairman of the Federal Trade Commission's advisory committee on cost justification. His talk is, of course, of great interest since everyone interested in the Robinson-Patman Act has been waiting for some time to hear what the advisory committee has to say on the subject.

His background makes clear the reasons for his selections as chairman of the committee and as our speaker today. He is a Professor of Accounting at the University of Michigan, as well as Assistant Dean. He has advised a number of government agencies on cost-price problems. He has probably written more on the use of cost in government regulation of price than any other accountant in the country.

We are fortunate in the privilege of having such a distinguished panel.

MARK S. MASSEL

COST JUSTIFICATION AND THE FEDERAL TRADE COMMISSION

by

Corwin D. Edwards*

In its handling of the problems of cost, the Robinson-Patman Act broke new ground. It assigned to respondents, rather than to the Government, the responsibility for deciding whether or not considerations of cost should be brought into most price-discrimination cases and for introducing whatever cost data were to be considered. By thus shifting the burden of proof as to cost to the respondent, it brought about in practise an informal give-and-take as to accounting questions that contrasts sharply with the handling of cost problems in other types of litigation such as public-utility-rate cases. This procedure obviously makes for an easier consideration of the relevant cost issues. We are often told that it has also exposed respondents to arbitrary views of accounting entertained by the Federal Trade Commission.

The act broke new ground as to cost in another respect which has been a major source of difficulty both for the enforcement agency and for businessmen desirous of complying with the law. It demanded of those who offer a cost defense a meticulous allocation of expenses reaching far beyond the standards of precision that prevailed in cost accounting at the time the statute was passed. Both the language of the act and the interpretation of that language in reports and debates in Congress were designed to make sure that costs offered in defense of a price discrimination might not be allocated on grounds that were merely strategic or historical. Instead, cost differences were to be derived from specific imputation of relevant costs to particular transactions that varied in such matters as the method of delivery or the quantity delivered. A concern which wished to have the cost defense available for justification of the differences in its price structure was thus invited to maintain currently a record or a reliable estimate of the division of its costs among classes of customers, transactions or different sizes, and any other subdivisions of the distributive process that became the basis for differing prices.

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I have personal reason to believe that the passage of the law brought about a widespread reexamination of price differentials and a considerable change in the discounts that had been previously received by some large customers. During the early months under the act, the Federal Trade Commission authorized its staff to hold informal conferences with business enterprises that wanted to find out how their pricing practises were affected by the new law. I was then an employee of the Commission and participated in many of the conferences. The possibility of cost justification was prominent in the discussions. In conference after conference it appeared that the most common basis for a cost justification lay in the fact that the process of sale and delivery involved a lump-sum cost of a given amount regardless of the size of the transaction. Where more units were sold, the lump sum could be subdivided into smaller fractions per unit. It is obvious, however, that where this is the sole basis for a cost justification, it will justify very substantial price reductions between the purchase of one unit and the purchase of two or between the purchase of two and the purchase of 4, but that the possibilities of cost justification quickly become negligible as the number of units increases. When a customer buys 500 units, each unit accounts for only 1/500th of the lump sum and little further economy per unit can be attained if the number of units is increased to 1,000. Thus, this type of cost justification may be used readily in defense of substantial price differences among small customers who buy slightly different quantities but it cannot afford much protection to a grant of substantial discounts upon large quantities as compared with quantities of moderate size. This point was widely recognized in the informal conferences and there was indication that, in order to keep the cost defense available, many of the conferees proposed to change their price structures. There may be some connection between the prevalence of this intent and the fact that in the subsequent enforcement of the statute the Federal Trade Commission has issued only two orders pointed directly at the discounts granted upon large quantities bought in a single transaction for a single delivery.

Even after enforcement by litigation began, a major role of the cost defense continued to be the informal handling of matters that never came to complaint. When the Federal Trade Commission undertakes to investigate a practise to which the cost defense is pertinent, it is common for those being investigated to say that their price differences

are justified by cost and to offer the Commission informally the evidence underlying the assertion. In such instances the Commission's accountants examine the cost information submitted and sometimes ask for and receive supplementary information and explanations. When in the opinion of these accountants the cost defense is valid, they indicate the fact by appropriate memoranda within the Commission, and, if their views are persuasive, no complaint is issued. How often this has happened there is no way of knowing, for the Commission does not make public summaries of the investigations that do not lead to complaint. In examining the treatment of cost after complaint has been issued, however, one must bear in mind the probability that the issuance of the complaint means either that no cost defense was submitted to the Commission or that the Commission's accountants found what was placed before them not convincing.

There has been sustained criticism of the Federal Trade Commission's handling of cost problems in the trial of price-discrimination cases. The Commission's attitude has been described as over-meticulous and even as doctrinaire. Among those who have given support to this view is a distinguished ex-Chairman of the Federal Trade Commission. The belief that there are unrealized possibilities of giving vitality to the cost defense was undoubtedly responsible for the appointment of the committee of which Professor Taggart is chairman. Until that committee's final report is available, an assessment of the proper place of the cost defense and an evaluation of the Federal Trade Commission's handling of the matter would be obviously premature.

However, one aspect of the problem can be discussed without waiting for the report. This is the factual record as to the importance the cost defense has had in Commission cases and as to the reasons why various cost defenses have not been accepted by the Commission. It is this part of the broad question that I wish to discuss. What I have to say is based upon a recent examination of all the cease-and-desist orders issued under the Robinson-Patman Act, which I undertook as a first step in the study of the impact of the orders upon business practise which is being made by the Brookings Institution. I regret that I have not yet examined the 101 cases in which complaints were dismissed without order. But since we have the authority of the Commission's former chairman to the effect that the cost defense

has been accepted in very few instances in deed, the omission of these cases is not as important as it might otherwise be.

In the cases that resulted in cease-and-desist orders, the cost defense has played a relatively small part. In most of the cases, the cost defense has not been relevant to the violation charged, and where it has been relevant, the respondent has usually chosen to accept an order without offering a defense of any kind. There have been few cases in which the discrimination found was of a kind that might reasonably be cost-justified. There have been still fewer in which a change in the Federal Trade Commission's approach to problems of cost would have been likely to result in acceptance of a cost defense which the Commission actually rejected.

In arriving at these tentative conclusions, I have found them surprising, and I do not expect you to think them self-evident. Let me offer you briefly the evidence upon which they rest.

From the beginning of the Robinson-Patman Act to December 31, 1954, the Federal Trade Commission issued 239 cease-and-desist orders in price-discrimination cases.

In most of the 239 cases, however, the violation charged and found was one to which the cost defense was not applicable. A difference in cost may be used to justify a difference in price between customers and is therefore relevant to a charge of violation of Section 2a of the act. But it is not relevant to a violation of Section 2c, which has to do with illegal brokerage. Where the brokerage provision has been violated, the offense consists merely in the fact that a seller has paid brokerage to a buyer or his representative. No cost defense can excuse this payment. Of the 239 orders, 125 were issued in cases involving solely the payment of illegal brokerage.

Similarly, where Sections 2d or 2e are at issue, violation consists in preferential provision of selling assistance, such as the payment of demonstrators, or preferential purchase of selling services, such as payment for advertising done by distributors. In such cases the offense under the law is a lack of proportionality in the help given or the payments made. A showing of cost differences does not justify the practice. Of the 114 cases in which something more than the brokerage provision was violated, 15 were concerned only with such issues of proportionality.

There have also been a few cases in which a buyer was ordered to stop violating Section 2f of the act by knowingly inducing or

receiving an illegal discrimination. Where what was received was a preferential price, such as is condemned by Section 2a, cost differences were relevant. But in the Automatic Canteen case it has been determined that when the respondent is the buyer rather than the seller, the Commission carries the burden of proof as to cost. Though this determination is recent, it has sprung from the first case in which the cost issue has been clearly posed under Section 2f. The earlier proceedings involving that part of the act may be ignored because cost defenses did not arise.

Only 91 of the 239 orders are based upon findings that Section 2a had been violated. It is only in these 91 cases that respondents might have been acquitted if they had presented a satisfactory cost defense.

But in most of these 91 cases, as in most of the remaining 148, the respondents offered neither a cost defense nor any other kind of defense. In 178 of the 239 cases in which orders against price discrimination have been issued, the respondent filed an admission answer, accepted a consent order, or otherwise agreed to the entry of an order without a contest. In 2 cases the respondents did not answer or appear. In 13 cases the respondents admitted the facts but argued the law or the content of the order. In 5 cases the respondents offered no evidence. In 2 cases, after evidence had been submitted, final argument was waived. Thus, there were only 39 instances in which the Commission's order was preceded by full use of the opportunities open to the defense.

Where no serious defense of any kind was undertaken as to questions of fact, the absence of a cost defense is to be merely regarded as one aspect of a decision not to contest the proceeding. One may speculate whether or not, if cost defense had been easier, there might have been more contests; but there is no way of finding the answer.

Only 18 of the 39 fully contested cases involved violations of Section 2a to which a showing of cost differences would have been a valid defense. For practical purposes we may look to these 18 cases in considering whether the opportunity of respondents to defend themselves by showing cost differences have been curtailed further than is inevitable under the standards of the act.

In some of these 18 cases the discrimination was of a kind that could not be reasonably related to cost differences. The group in which this was most obviously true consisted of 6 cases in which the discrimination was incident to the use of a basing-point or zone-pricing

formula. In a basing-point system, the delivered prices at different delivery points do not reflect the relative freight costs of shipment to those points. Prices vary with freight charges only when the shipper sells f.o.b. mill. Wherever defenses are available in a basing-point case, a cost defense is not one of them. Similarly, in a zone-pricing system, the uniformity of the delivered prices within a zone necessarily results in different mill net realizations because the shippers' freight costs are different to different destinations; and the differential in price between the various zones is almost certain to overstate the difference in freight cost between points that are close to each other at a zone boundary and to understate the difference in freight costs between points that lie at the remotest extremities of the respective zones. Here, too, the cost defense is automatically precluded by the nature of the price variation. It is not surprising that in basing-point and zone-pricing cases the respondents have not troubled to cost-justify their discriminations.

There were other discriminations, too, for which a cost defense was impossible or obviously difficult. In one case the Gommission found that a seller had cut prices below his cost in the area surrounding a large city for the purpose of destroying a localized competitor. The offense involved a deliberate departure from cost as a guide to price policy. In several cases some or all of the discriminations which were found to injure competition took the form of varying price concessions, each made to an individual customer. In these instances nothing short of cost allocation to each customer separately could have laid a basis for cost defense. There were also cases in which a respondent departed significantly from his own pricing schedule: for example, by allowing volume discounts to customers who did not buy the volume to which the discount supposedly applied. In these instances a cost justification of the discount schedule would not have justified the off-scale selling, and presumably a cost justification of the off-scale selling would have implied a lack of such justification where the scale was observed. In some of the volume-discount schedules a buyer was permitted to count as a part of his volume not only his own purchases but also purchases that had been made directly from the seller by the buyer's customers. In other such cases the central office of a buying organization was given a discount upon the aggregate volume of the purchases that had been separately made by, and separately delivered to, different branches of the buying organization.

Such pooling of purchases which involved separate sales contacts, separate transactions, and separate deliveries is obviously difficult to justify on a cost basis. In the 12 cases under Section 2a that did not involve a geographic pricing formula, there were at least 6 involving discriminations of one or more of these perverse types.

The cases in which respondents offered cost defenses have one striking common characteristic: Apparently none of the respondents had devised methods of recording and analyzing costs currently in such a way that management could determine price differences in the light of cost differences. Even the most careful of the cost defenses were based upon studies undertaken for the purpose of developing a defense in a pending lawsuit. In consequence of this procedure, respondents encountered many difficulties in obtaining adequate cost information and justifying the methods of allocation which they used.

In one of the 12 cases that did not involve geographic pricing formulas, no cost defense was offered. In another the Commission accepted the cost defense for the parts of the price schedule which the defense covered, but issued an order as to other parts of the schedule for which no offer of cost justification was made. In a third case the decision was based upon a stipulation conditioning the findings and order upon the decision as to respondents who were fully tried in another proceeding. In one case the Commission's finding of sale below cost to destroy a competitor meant that no cost defense could be valid. In one case each large customer had paid a different negotiated price, and the lack of system in the price structure precluded a cost defense. In still another case the Commission rejected the cost defense in a summary statement that provided no reasons.

There were among the 12 cases, however, 6 in which a cost defense was offered for a price structure that might conceivably have been cost-justified, and in which the Commission's findings include an analysis of the weaknesses of the cost defense. Most of the defects mentioned do not depend upon niceties of cost accounting but instead point to an inappropriateness of concept and a paucity of information which was inevitably fatal to the defense. The most common defect was the use of principles of cost allocation for which no record basis was laid. In the Standard Brands case, for example, the first step in cost justification was to divide costs by product classes in order to ascertain the proportion of costs which should be attributed to bakery products, these alone being involved in the proceeding. By an exer-

cise of judgment unsupported by business records, the management assigned 42 percent of cost to bakery products and 58 percent to grocery products. It then made a study of that part of the costs which could be traced and found that 36 percent of these costs was attributable to bakery products and 64% to grocery products. Nevertheless, the original allocation of the total costs was retained, with the result that, of the costs not directly traceable, 52 percent were assigned to bakery products and 48 percent to grocery products. The original managerial estimate was used in allocating total costs in spite of the fact that the limited evidence that could be obtained tended to refute rather than confirm it.

There were other substantial weaknesses in the cost justifications. In at least one case, the respondent averaged the prices charged to different groups of customers and sought to justify the averages rather than the actual prices, though the actual prices differed substantially within each averaged group. In at least 2 cases, efforts were made to justify special price concessions to 2 or 3 large customers by comparing the costs of serving these concerns with the average cost of serving all other buyers; the latter were lumped together in spite of the fact that they included different classes of buyers who paid different prices and that among them were some concerns that bought by methods similar to and in quantities as large as the favored 2 or 3. In several cases, items of overhead cost which were not shown to arise from any particular part of the business were attributed solely to the disfavored customers and not at all to the favored ones.

In pointing out these defects of the cost defenses, I do not, of course, intend to criticize either the companies or the counsel who offered them. Presumably they found themselves baffled by the weakness of their own cost records and the difficulty of making satisfactory cost studies *ex post facto*.

The record of the cases suggests that cost differences are relevant to violation of the Robinson-Patman Act less frequently than has been supposed, and that where such differences are relevant, respondents have seldom been able to submit a cost justification of a quality that would merit acceptance.

Would greater emphasis upon the development of accounting for distribution costs enable business enterprises to make their price decisions more safely and to defend them better on a cost basis when they are challenged? Is the task of providing cost allocations good

enough to justify price differentials one that outruns the possibilities of cost analysis? Are there any shortcuts through which price differences that reflect differences in the efficiency of the distribution process can be distinguished from those that do not? The Brookings study is still in its early stages. It cannot now supply answers to such questions, and there is as yet no way of knowing whether it will eventually be able to do so. Meanwhile, we await eagerly the results of the study by Professor Taggart's committee.

COST JUSTIFICATION OF QUANTITY DIFFERENTIALS

by

ALBERT E. SAWYER*

I am very happy to appear before the Section on Anti-Trust Law of the Illinois State Bar Association, in company with my good friends, Corwin Edwards and Herbert Taggart.

I plan to proceed in this discussion from the assumption that the desire of counsel is at least as much to prevent the growth of situations which breed potential litigation as it is to successfully defend a client who faces a Robinson-Patman complaint.

I.

My first observation may be one that is already entirely familiar to you. Unlike many other statutes, the Robinson-Patman Act[1] tends to impinge upon a particular business situation at several different points simultaneously. By this I mean that you can never safely catalog a problem as reading upon one particular aspect of the Act. Life under the Robinson-Patman Act is never quite so simple. You may be dealing with a quantity discount but that is not alone a question of cost justification under the proviso of Section 2(a). It is a lot of other things beside. Is there the requisite injury or potential for injury to competition? This is a question which may be asked several times in the course of your inquiry into a particular problem because changing circumstances change the impact of the price differential upon the competition which the Act purports to protect. Then, too, is your differential a response to competitive impacts? Is the "good faith" clause of Section 2(b) brought into play? Consideration must also be given to the "changing conditions" clause and the outright exemption of certain classes of buyers.

Long before you settle down to the problem of cost justifying a price differential and start a discussion with your client's accountant, it is necessary to face up to the sometimes intricate problem of determining whether the differential in price which constitutes your

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1 15 U. S. C., Sec. 13.

problem is in fact between "goods of like grade and quality." We will consider some of the involvements of such an inquiry a little later on.

Suffice it to note at this point that these substantial preliminary considerations must be explored rather fully before you are sure that the price differential which has been placed in front of you for your legal review or defense is one which must meet the ultimate test of cost justification under Section 2(a).

I use the term "ultimate test" because whatever the difficulties of these preliminary considerations may be, it is pretty certain that they will involve a lesser degree of effort and expense than will be required if cost justification becomes the crucial test of the legality of the price differential. We must face up to the fact that the cost test is a hard one to establish. It must be thoroughly and skillfully done or it will be of little or no value in solving your problem.

It is evident, therefore, that before you are ready to call upon your client's accountant you have brought into play a very substantial part of the entire Act, but in so doing you may have resolved your problem upon grounds much more certain than that of cost justification.

It is far beyond the time limits of this discussion to treat in any comprehensive manner each of these preliminary inquiries. Each is a topic of its own and each has many and various applications dependent upon the type of product, the type of market in which it is sold and the competitive structure upon which the price differential may impinge. There are one or two general observations, however, which may prove helpful to counsel looking at a price differential before it goes into effect or before it has been made the subject of litigation.

Regardless of absolute magnitude it is always profitable to appraise the probable impact of a price differential upon the competitive structure of the market in which the goods are sold. A differential in price is not unlawful under the Act unless the plaintiff can establish an injury to competition or the reasonable probability of such injury. The competition affected may be that among the sellers of the commodity or the buyers or the customers of either. It is pretty well settled by the cases that this injury, whether real or probable, must be substantial in nature. It may well be that a differential in price of some magnitude sold for consumption by customers not in competition with one another, where the item sold is but a minor element in the cost of the consumer's output as, for instance, a shipping tag sold to a

steel mill or a meat packer, could promptly be dismissed as not inviting injury to competition if you could satisfy yourself that as between your client company and its own competitors the differential would not tend to block the competitors entirely from that type of business. This line of inquiry calls for a full understanding on your part of the business situation of which the price differential is a part and an understanding from sales management of the client as to the real purpose and functions of the differential. Just what is it designed to accomplish?

I mentioned earlier that it may be necessary to take a second look at the question of injury to competition. It is now fairly well settled that the impact of a differential upon a competitive situation must have substance. A trifling impact is not sufficient to outlaw a differential. If in the course of a cost justification study cost differences equal to a large part of the differential can be demonstrated, the unjustified balance may be sufficiently small to destroy the inference of injury to competition. Thus a partial cost justification may sometimes remove a differential from the state of probable unlawfulness. You as counsel must appraise the added risk that reliance upon such a conclusion implies.

When considering the preliminary question as to the value of the defense under Section 2(b)—that of meeting the equally low price of a competitor in good faith—counsel must be particularly realistic and guard against being carried away by the wishful thinking of the client's sales department. What probative evidence is at hand concerning the lower price of a competitor which must be met by a particular price differential? As you well know, this area of the law is in a state of flux. Several opposing legislative proposals are pending before the Congress and the decisions are at variance as to what constitutes "good faith" as applied to this Section. However, if the evidence of the existence of the lower price is strong and the manner of meeting it by your company is the least that can be expected to hold the business in the face of the specific competition there is a good chance that the rebuttal would be sustained.

In connection with the inquiry concerning like grade and quality it is well to remember that the Commission has thus far resisted attempts to depart from the physical tests as to what constitutes likeness and similarity of quality. It has been urged that consumer preference built up through advertising and sales promotion or through

buying habits of long standing create economic differences in otherwise identical products and that these should justify differentials otherwise unlawful. As the matter stands at the moment the physical characteristics of the products to be compared determine these issues.

When, by reason of these preliminary inquiries, counsel is satisfied that the differential in question would probably be outlawed except for a showing of cost justification, he is ready to take up this phase of the defense.

II.

At this point, it is important to consider briefly the nature of the term "cost" as it is used in the cost justification proviso of Section 2(a) of the Robinson-Patman Act. It is my belief that a better understanding of the problems inherent in this proviso will be possible only if approached with a realistic understanding as to the nature of the term "costs" as evidence in an attempt to justify a price differential under this proviso.

The cost proviso of Section 2(a) of the Robinson-Patman Act deals with an important phase of accounting procedure when it specified that certain price differentials are justified, which would otherwise be unlawful, if they *"make only due allowance for differences in the cost*

of manufacture—
sale—
or delivery—
resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered."

Thus the proviso opens the door not to a consideration of the *total* costs of manufacture, sale or delivery, or all three, but to *differences* between one set of costs and another. These costs are not the costs of the product itself but rather of specific functions of the total cost involved in the production and distribution of an article or group of articles.

The only costs that are eligible for consideration under this proviso are those which result from certain differences in the procedure of dealing with particular purchasers or classes of purchasers, to wit, those paying the higher of two prices and those paying the lower.

The excuse for the two prices rests in a difference either in *quantity* purchases or *method* of delivery or sale. Each of the differing methods or quantities must be assigned a cost—*a partial cost*—of the total operation of producing, selling and delivering. Furthermore, the field of inquiry is further narrowed by requiring the differing methods to be related to particular customers or classes of customers receiving the differing treatment.

So circumscribed and delimited we find that we are dealing in this proviso with a highly synthetic concept which has little or no direct relationship to ordinary everyday steps taken in recording the transactions which constitute the selling or delivering of products to customers.

To many people "accounting" is an homogenous agglomeration of record keeping by which a business keeps itself on balance with its employee, suppliers, customers, stockholders or partners and, last but not least, the tax collectors. The end results constitute the payment and receipt of money payment. This is but one phase of accounting procedures—that which is generally referred to as "*financial accounting.*" Such records do not automatically reveal the "costs" of doing any particular element or function of the business. *Total expenses* of a month, quarter or year may be derived from such records and under some circumstances an intelligent overall average "cost" figure may be derived by the simple act of dividing total units produced, sold or delivered into this very general overall aggregate expense.

Such a figure, however, would be of no use whatever in connection with a problem arising in the usual manner under the cost justification proviso of Section 2(a) of the Robinson-Patman Act. It covers *all* products and *all* methods of manufacture, sale and delivery. The proviso of the Act is concerned with differences in cost of but *partial* elements of specific products which may be but a very small part of this overall aggregate.

In a practical sense the single product, distributed in a single manner, almost never occurs.

To get at these partial elements we must, to a large extent, desert the bookkeeper and take on the techniques of the appraiser.

Cost accounting, as distinguished from financial accounting, constitutes the art of reaching reasonable approximations of these very limited partial costs. Thus these two sets of accounting procedures

run parallel to each other, with certain thin connecting threads for the purpose of overall "reconciliation" but otherwise each is an independent set of calculations based upon entirely separate accounting assumptions.

This exposition of the distinction between cost accounting and financial accounting is a necessary preface to an analysis of the problems posed by the cost justification proviso of the Act because of the common error of supposing that the data required to prove or disprove "due allowance" can be garnered from the ordinary books of account which every business is required to keep by necessity.

Therefore, we must recognize at the outset that we are dealing not with the problem of record keeping on a day-to-day basis and provable as such, but with what are essentially numerous series of estimates, the validity of which rest, in large measure, upon the standard of care and good faith which brings them into being.

This poses the essential difference in the problems of proof inherent in cost justification presentations and those which arise when ordinary books of account are brought forward as proof of a contention in litigation. The probative force of the latter derive from the careful execution day-by-day of a routine established long before the issues in litigation arose. The emphasis is upon the routine nature of the record keeping operation and the narrow scope within which individual judgments may operate to consciously color the result. In the former, however, the routine operation is minimized and in most cases the area dependent upon individual and collective judgments applied to specific situations predominates. Here the probative value of the particular cost accounting procedure rests heavily upon the subjective qualities of the individuals who execute or direct the particular piece of work under review.

It is in this setting, therefore, that counsel must view the practical considerations that confront the businessman, the Federal Trade Commission and the Courts in dealing with the cost justification proviso of Section 2(a) of the Act.

We should now translate these accounting concepts into the legal problem of evidence which they present. Counsel should be well aware of the problem of proof when calling upon the accountant for the required studies.

III.

The justification of a price differential by showing that it is but "*due allowance for differences in the cost of manufacture, sale or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered*" is essentially a problem in treating "*reliable, probative and substantial*" evidence as required by the terms of the Administrative Procedure Act.

Whenever the difference in price arises from a difference in method of purchase, or in the quantity purchased, which requires an allocation of internal costs among various classes of products and classes of customers, all of the intricate techniques of the cost accountant described heretofore are brought into play. The problems of proof then center upon the question whether such presentations, resting as they do in large measure upon the subjective qualities and judgments of the individuals who execute or direct the particular presentations constitute acceptable evidence.

As previously indicated, the Administrative Procedure Act requires that the evidence of cost justification be "reliable, probative and substantial." In all but the simplest cases the reliability of the evidence must be tested not against the accuracy and completeness of the data presented, but more largely upon the soundness of numerous subjective judgments of the witness as to the methods of allocation of various types of expenses common to several classes of products or classes of customers. These the accountants refer to as "joint costs." To segregate or allocate such costs to particular products or particular classes of customers requires the exercise of an informed judgment. There is usually a choice of alternative methods. Objective tests, such as a time and motion study of representative samples, may fortify a particular selection. In many cases, however, such objective tests are impracticable or unavailable within the reasonable bounds of time and cost. Reliance is then placed upon the judgment of the person directing the study. The hearing officers and the courts must therefore base their rulings as to the reliability, probative force and substance upon the collective judgments which form the foundation of these cost justification presentations.

When counsel presents a cost justification on behalf of his client's challenged differential there are some special considerations to which I draw your attention. Unless the entire study can be put into the

record by stipulation, and this is seldom possible, the foundation for it must be laid through the testimony of the accountant who prepared or supervised the preparation of the study. Counsel should bear in mind the strategical importance of bringing out on direct examination of this witness each instance in which joint costs have been computed by means of arbitrary allocations between various products, processes or customer classes. In other words, your presentation will gain much strength in the eyes of the hearing examiner or the court if the full basis of each such subjective determination is brought out fully and frankly as part of the direct examination of the witness. If the witness considered alternative methods of allocation these should be revealed and the reasons for the selection of the method used should be fully stated. Sometimes the witness will have relied upon allocation formulae which have been used by the company for many years and thus have historical support. I believe that where such formulae are relied upon the witness should be prepared to show that the present conditions warrant a continuation of the historical method. There is no particular sanctity to past practices just because they have been followed for some years. Furthermore, if the witness has incorporated into his study the allocation formulae worked out by others he should be prepared to show that he adopted these methods of his own choice after thorough consideration of the soundness of the procedures. He must assume full personal responsibility for such adoption.

A good deal of court time would be avoided if there were a full realization on the part of opposing counsel of the fact that cost studies of this sort necessarily imply varying degrees of tolerance. A cost difference will hardly ever be a precise amount. It is more in the nature of range of values. Without this realization much time is wasted on cross-examination which seeks to press for admissions of minor inexactitudes. It would be more to the point if such cross-examination were directed to a thorough testing of the witness's bases for the allocation of joint costs, because there lies the strength or weakness of the study while, on the other hand, minor variances between the price differential and the ultimate cost difference are no more than should be expected in dealing with studies of this character.

It is important for all to understand, counsel for both sides and the hearing examiner or judge, that in this type of presentation much weight must be given to the calibre of the witness, his apparent pro-

fessional skill and his appreciation of his professional responsibility to deal fairly with the data before him.

Thus far we have considered what counsel should inquire into regarding a price differential, whether it be one that is challenged or one that is merely under legal review, before concluding that it must stand the test of cost justification. We have further considered the nature of "cost" as an accounting concept in an attempt to visualize the kind of data counsel must expect as a result of a cost study undertaken for the purpose of satisfying the proviso in Section 2(a). Then, we have considered what standards of proof properly apply to evidentiary data of that kind, and some of the things counsel must expect to face when presenting such data in an administrative proceeding. I believe that it is highly important that counsel approach the application of the cost proviso with this broad understanding of the task which lies before him. Otherwise he is likely to meet with unpleasant surprises both as to what he receives from his accountants and what happens to both counsel and the accountant in the hearing chamber.

IV.

Let us turn now to the context of the proviso. Few more highly complex concepts were ever crowded into so few words.

Fortunately for me at this moment the most that needs to be said of the context of the proviso lies properly in the field of the accountant, here represented by my good friend Professor Taggart and in the field of economics which is being dealt with so authoritatively by my equally good friend Dr. Edwards. The purely legal aspects of the context of the proviso may appear to be disappointingly brief and scanty.

First, let us consider the legal implications of the phrase *"differentials which make only due allowance. . . ."* Your accountant will rely upon counsel's interpretation of this phrase to determine the all-important question as to how precise he must be in his calculations and estimates. If you read the Supreme Court's statement in the *Morton Salt*[8] case that discounts "can be justified by a seller who proves that the *full amount* of the discount is based on his actual savings in cost" in a literal sense you will pose to your accountant an

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[8] *Federal Trade Com.* v. *Morton Salt Co.*, 334 U. S. 37 (1948).

almost impossible task. We have already seen that such cost savings do not lend themselves to such literal exactitudes. If we read into this statement some portions of the Federal Trade Commission's statements in the *United States Rubber Company*[3] case and again in the *Minneapolis-Honeywell*[4] case we note that the Commission is aware of the true nature of such costs and acknowledges that "there is inherent in them a reasonable margin of allowable error." We find also reference in the earlier Commission decision in the *Kraft-Phenix Cheese*[5] case of what it called a reasonable inference of a supporting cost difference. Perhaps the most recent Commission pronouncement appears in the *B. F. Goodrich*[6] case (1954) in which it disregarded certain minor elements of a differential which were not supported by cost differences.

It would seem therefore that the Commission has interpreted the statute and the Supreme Court's reference to the cost proviso as something to be applied with a degree of flexibility that would accommodate marginal differences which, in and of themselves, do not amount to the requisite injury or threat of injury to competition.

The proviso refers to differences in the cost of *"manufacturing, sale and delivery"* as proper areas from which to derive justification. The Congressional debates[7] and the Committee reports[8] on the Act shed some light upon what was in the Congressional mind as to the scope of the costs so designated in the proviso. Recently, the Commission has given us some further light on the significance of these words. (See particularly *U. S. Rubber*[8a] and *Goodrich*[8b] cases.) Time does not permit a detailed commentary. It would appear to be clear, however, that it was never the intent of the Congress to obstruct the passing on of economies arising from such cost differences in

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3 *In the Matter of United States Rubber Company*, 46 F. T. C. 998 (1950).

4 *In the Matter of Minneapolis-Honeywell Regulator Co.*, 44 F. T. C. 351 (1948).

5 *In the Matter of Kraft-Phenix Cheese Corporation*, 25 F. T. C. 537 (1937).

6 *In the Matter of The B. F. Goodrich Company*, Dkt. No. 5677 (1954).

7 See *e.g.*, Cong. Rec. Vol. 80, pp. 9559-9560 (1936).

8 See *e.g.*, H. R. No. 2287, 74th Cong., 2nd Sess. (1936).

8a See footnote 3, *supra*.

8b See footnote 6, *supra*.

manufacturing and distribution areas provided, of course, that they arise as a result of some difference either in the quantities purchased or the method by which the purchases were made.

This of course leads directly to a consideration of the two words "... *resulting from* ..." which are the words of limitation reading upon the area of costs to be considered. This gives rise to the rather difficult question as to what kinds of cost difference arise from a difference in quantities and methods of purchase of the same commodities to different purchasers. It is pretty clear from what is said in the Reports of the Congressional Committee[8a] that these words were intended to limit the scope of cost differences which can be attributed directly to either a difference in quantity purchased or a variation in the way in which the purchases are made. In other words the reasons for the cost difference must be made apparent on the face of the justification study. The way in which this may be done is fairly well illustrated in the Commission's decision in the *United States Rubber Company* case which we have referred to heretofore. This particular requirement does not seem to have posed difficult problems upon those who have presented justification studies.

Last, but not least, in the context of the proviso we must consider the words "... *to such purchasers sold or delivered*...." This introduces the difficult and troublesome question of customer classification. May one customer be grouped with others with similar characteristics insofar as volume of purchases or method of purchasing is concerned for the purpose of determining differences in the cost of serving them? I will consider only what would appear to be the legal limitations upon such a practice under the terms of this proviso.

In the Congressional debates and the committee reports there is no clue as to the intent of the Congress with respect to customer classification for cost justification purposes. In two cases, *Bruce's Juices*[9] and *Russellville Canning Company*[10] the Federal Courts have indicated conflicting points of view, the former holding that the statute calls for a test of cost differences on a customer by customer basis. It ruled out the grouping upon which the cost defense was based. In the few cases in which this matter has been in issue the Commis-

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8a See footnote 8, *supra*.

9 *American Can Co.* v. *Bruce's Juices*, 190 Fed. 2d 73 (5th Cir., 1951).

10 *American Can Co.* v. *Russellville Canning Co.*, 191 Fed. 2d 38 (8th Cir., 1951).

sion has recognized the practical necessity of permitting reasonable customer grouping for cost justification tests. Thus, the first case to arise under the cost proviso (*Bird & Sons*)[11] presented a customer grouping held to be properly justified by cost accounting procedures. Numerous later cases have presented more or less elaborate customer groupings, some relating to quantity of individual orders purchased, others specifying series of monthly or annual dollar volumes of purchases as subject to varying discounts. Perhaps the best statements by the Commission on this subject appears in the opinion in the *Minneapolis Honeywell*[11a] case. From the standpoint of the Commission the propriety of reasonable classification is acknowledged in principle, the validity of any particular classification being a question of fact to be determined in each case in which the cost justification is presented in terms of customer groupings.

Much more could be said concerning some of the legal problems implicit in the context of the cost proviso but our time has run out. I hope I have presented enough however to direct you to the most fruitful source material should more thorough research be necessary. I hope also that in presenting the lawyer's problems under the proviso I have not trespassed too much upon the accounting and economic considerations which form an integral part of this complex piece of administrative machinery.

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11 *In the Matter of Bird & Son, Inc.*, 25 F. T. C. 548 (1937).

11a See footnote 4, *supra*.

WORK OF THE COST-JUSTIFICATION COMMITTEE

by

HERBERT F. TAGGART*

This is the second time I have been called upon to comment before a group of lawyers on the activities of the advisory committee prior to the issuance of its report. The first time was not so bad, since we had then missed our original deadline by less than a month. We are now more than ten months late, and if this continues, it can become embarrassing.

The delay is, of course, largely my own fault. I deliberately recommended for appointment to the committee men whom I knew to be both extremely busy and possessed of very positive opinions on the matters which the committee would discuss. No one was appointed because he would be a rubber stamp. As a result, our report has gone through a considerable number of drafts and is still not ready for publication. The most recent draft was optimistically designated as "semifinal." Its date of circulation was August 12. The "final" draft looks farther away now than it did then. I begin to appreciate to some extent the problems which confronted Professor Oppenheim and Judge Barnes.

While I cannot, therefore, report to you in any final way on the accomplishments of my committee, I have no hesitation in discussing some of our problems and disclosing some of the conclusions as to which there appears to be unanimity.

The first and in some respects the most important conclusion to be derived by the discerning reader from our report is that it is better to comply than to defy. We have not come up with a magic formula which either eliminates the requirement for painstaking and detailed cost study or materially decreases its scope or its cost. In spite of anything our report may accomplish, business concerns who indulge in different prices to different customers for the same articles will be well advised to give serious and realistic consideration to the cost factors involved. This is particularly true of large and prominent companies whose success in getting their names before the public has been such that they have made themselves prime targets for action if

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they transgress. Such companies may in some instances be well advised to make a Robinson-Patman-type cost study even before they come under the guns of investigation and complaint—if for no other reason than to get in practice when the lightning strikes.

Even the pygmy in an industry is not immune, as a Chicago company recently found out to its sorrow, and the cost and complexity of a R-P cost study does not decrease proportionately with the size of the respondent.

In the balance of my remarks I want to recount a few of the things my committee has and has not done—or, to be more precise, will have and will not have done when the report is completed. Perhaps I should start with the negatives in order to end this discourse on a positive note.

I have already mentioned one of the things we have not been able to do, namely, to find a way to eliminate the necessity for a detailed cost study when a complaint under section 2(a) has been issued. Many commentators on the subject have been appalled at the magnitude and expense of such cost studies and have expressed the hope that some means might be found for avoiding time studies, counting of invoices, orders, salesmen's calls, and the other multifarious statistics of manufacturing and distribution operations, and the preparation of reams of work papers and supporting documents. The members of the committee have at no time been under any illusions in this area. We know that the disease may not be cured, though adoption of certain measures may to some degree ease the pain and shorten the convalescence.

A second thing we have not done and will not attempt to do is to prepare a manual of cost-justification procedure. Such a manual is unfeasible because of the infinite variety of manufacturing and distribution organizations, channels of trade, functions and combinations of distribution functions, cost factors, terms of sale, and every other aspect of business organization and operation. Even an individual company, where such matters are to some extent static (though never too static!) would have trouble preparing a useful manual for itself because of the fact that it must first guess precisely what form a price-discrimination complaint may take and what segments of its business may be involved.

We shall also not recommend continuous R-P accounting. I have never felt that there was as much delusion on this point among non-

accountants as has sometimes been assumed. I am inclined to believe that few laymen (in the accounting sense) are so unsophisticated as to believe that a record-keeping system which will give an immediate answer to every R-P problem can be devised or would be economically feasible. The experience of American Can Co., which actually carried out an ambitious project of this sort for nearly five years, does little to encourage emulation.

This matter as well as some others with which the committee has had to deal, has a special aspect of which we have tried not to be unmindful. This is the fact that price makers must make "due allowance" before transactions are consummated, though the costs considered in each litigated case have been those actually incurred in some past period. The committee would not like to lend even negative support to the proposition that because a company has not set up a Robinson-Patman cost-finding system it had not made "due allowance." Hence our very positive statement that continous R-P cost finding is not practicable.

If anyone has hoped that this committee would give any aid or comfort to the marginal cost approach to cost justification, he will be disappointed. Early in its deliberations the committee voted against putting negatives in its report with respect to cost elements or methods of allocation and analysis. This was because we recognized that in the infinite variety of situations which are presented in these cases, almost any cost item or cost analysis procedure might have a valid position. The marginal cost approach, however, is so clearly off limits that it seemed worth while to the committee to violate its general rule. The legislative history of the Act and its obvious intent are completely opposed to the proposition that "due allowance" has been made if only the *added* costs of a particular piece of business are taken into account.

A final element of negation which is nowhere formally expressed in the drafts of the report to date is our failure to encourage reliance on pure judgment or intuition with respect to cost differences. The respondents who have relied to a major extent on subjective appraisals of cost differences have not fared well, and the report will emphasize the importance of supporting opinion and judgment with objective data.

On the positive side, the committee's report will do what it can to encourage the Federal Trade Commission's willingness to interpret

"due allowance" with justifiable liberality. This tendency to be reasonable has evidenced itself in a number of decisions on cost matters—among them the Kraft Cheese, U. S. Rubber, Sylvania, and Goodrich decisions. The committee's ground for urging a continuance of the "de minimis" doctrine and similar aspects of reasonableness is the proposition that no cost analysis procedure in a complex situation can do better than to arrive at approximations. The results are reliable only in the sense that they determine a range or area within which the true cost differences may reasonably be said to lie: they do not pinpoint cost differences with precision. Hence judgments based on the results of such studies must recognize their approximate character.

The report will advocate a broad interpretation of the phrase "cost of manufacture, sale and delivery." It is the committee's position that there are few if any items of cost which may not properly be said to contribute in one way or another to the production of goods or their distribution. In the case histories there has occasionally appeared a tendency to place some costs outside the pale because of a notion that they are not costs of "manufacture, sale or delivery." No commission ruling seems ever to have been based on such a contention, and the committee's hope is that none ever will.

Visible in some of the cases has been a reluctance on the part of Commission staff to concede that differences in manufacturing costs may play an effective part in cost-justification proceedings. The U. S. Rubber footwear case appears to be a clear-cut concession in this area, and similar cost factors were espoused by Goodrich accountants in that successful demonstration of cost differences. While readily agreeing that such manufacturing cost differences as may exist must arise out of differences in methods and quantities of sale and delivery, the committee has not been willing to concede that they are necessarily negligible or confined to a few minor items of cost. Some space is therefore taken in the report to point out possible areas of cost difference in the manufacturing end, and to indicate approaches to their measurement.

In a much narrower area, the report will present a logical solution to the cash discount problem which occupied hundreds of pages of most unprofitable wrangling in the Sylvania case. The problem with respect to cash discounts is not one of cost differences, but relates to the definition of price differences. Since it affects the amount of

cost differences which must be demonstrated, however, the committee has felt that it comes within the area of its mandate.

In the Goodrich case and to some extent in others a problem has arisen with respect to the manufacturing cost differences which arise not out of methods or quantities of sale, but out of differences in specifications of goods purchased by different customers. In spite of minor specification differences, the goods in question may be "of like grade and quality." The committee has not attempted to derive a yardstick for deciding when such slightly different goods diverge too far to be of like grade and quality, but we will make a proposal which we think has a good deal of merit for the treatment of such cost differences.

The report will take a strong stand in favor of the propriety of reasonable classification of customers, commodities and transactions for cost-justification purposes. The Commission in all of its decisions seems to agree that classifications of customers and transactions are proper if they are reasonable in view of the purposes of the Act. Cost justification of each individual transaction with each individual customer has not been required. In the Sylvania decision a grouping of commodities was recognized as proper. If the Russellville and Bruce's Juices decisions were to prevail, cost justification would become a nullity through sheer weight of the enormous burden of proof, customer by customer, and transaction by transaction.

On the level of operations, rather than policy, the report will point out some of the pitfalls of cost justification and stress the desirable characteristics of cost analyses for this purpose. For example; we shall point out the advantages of using a sampling approach rather than trying to cover the universe. Some of the cost studies which have been presented to the Commission have attempted to cover all sales districts in a rather superficial way instead of doing a very thorough job on a few selected for their representative character. Among the good examples of the use of the sampling technique are the studies submitted by U. S. Rubber and Goodrich in their successful presentations. In the great majority of situations well chosen samples can save much time and money and at the same time actually give the Commission a better picture of company activities than a less intensive job on a company-wide basis.

While, as said before, we are not attempting to prepare a manual of cost-justification procedures, we are going to append to the report

a supplement which deals with the functional approach to cost analysis, pointing out its value as an analytical device and the way it may tie in with a company's established cost-control system. It is emphasized, however, that we have no desire by presenting these suggestions to straight-jacket any respondent into following any particular approach, and we express the hope that the Commission will not do so either. Operating organizations and procedures are so diverse, and the details of particular complaints are so unpredictable that no logical approach to cost justification should be ruled out, whether it conforms to some recommended procedure or not.

The committee has not contented itself with matters of accounting principle and procedure. We have felt that the time of the limited Commission accounting and trial staffs, to say nothing of the time and expense of respondents, could be saved by the adoption of a few organizational and procedural changes. For example, the experience of members of the committee suggests the advisability of consultation with the Commission accounting staff before a cost study is undertaken. In the course of preliminary investigation, before a complaint is issued, the question of cost justification may well arise, and the problems of cost study preparation may very possibly be considered at that point. In any event, after the complaint is issued consultation of this sort may be most desirable. It can save the respondent a good deal of wasted time and effort and can be just as useful to the commission staff, who may be relieved of having to contest an inadequately conceived and prepared study. The responsibility is the respondent's, of course, and the Commission accountants cannot be expected to hold the hands of those preparing the study—nor can the FTC accountants commit the Commission to the acceptance of any particular theory or procedure—but much time and expense may be saved on both sides by a judicious use of consultation.

One feature of cost-justification presentation which has created difficulties in several cases is the fact that the Commission staff insists, for the most part, on purely oral presentation of the testimony of its accountants. Whatever may be the tactical advantages of this policy, it is not helpful in what is or should be a fact-finding proceeding. In the opinion of the committee, it is both fair and desirable that the opinions of the FTC experts and the bases for them be available to both sides in the form of written statements and schedules. The com-

mittee heartily agrees with former Chairman Hawrey's statement that "Surprise and tactical advantages should be frankly eliminated in all administrative hearings" and in his advocacy of "exchange of written drafts of the proposed testimony of experts."

The committee also will advocate the appointment of an accounting adviser to the Commission who would be distinct from the present accounting staff and therefore in a position to give accounting advice directly to hearing examiners or the Commission. We realize the difficulties involved in this proposal, but it makes such good sense that we shall doubtless include it, even in the face of discouragements of whatever nature. The usefulness of such an advisor, if he can be appointed, would be great. Cost-justification problems are among the most complex faced by the Commission, and, with all due respect to Commission members and hearing examiners, they could benefit from the services of an expert and disinterested accounting adviser.

A final suggestion by the committee will be the issuance by the Commission of accounting opinions, similar to those issued by the Treasury or the SEC, covering questions of general importance arising in these cases. Such opinions might well be prepared by the accounting adviser, if one is appointed, but in any event they would be a useful followup of the work of this committee. As a matter of fact, some of the material in the committee's report might well be the subject matter of such opinions. It would be our hope that such published opinions would not straight-jacket the preparation of cost defenses, but that they would be of real assistance to the seller who is endeavoring to comply with the Act and who wants to be sure that his reliance on cost differences is well founded.

ANTITRUST NEWSLETTER

Supreme Court (Box Score) October 1955 Term (pending as of February 20, 1956)

Dkt. 5—*United States of America* v. *E. I. de Pont de Nemours & Co.* (U. S. D. C., Delaware), June 23, 1954 Appeal filed. Oct. 14, 1954 Probable jurisdiction is noted. Motion to clarify and define the assignment of errors is denied. Mr. Justice Clark taking no part. Oct. 11, 1955 Oral argument was presented by counsel.

Dkt. 34—*Sears, Roebuck and Co.* v. *Bruce A. Mackey* (Seventh Circuit), Feb. 24, 1955 Petition filed. Mar. 28, 1955 Petition granted, and case now awaiting oral argument.

Dkt. 76—*The Cold Metal Process Co.* v. *United Engineering & Foundry Co.* (Third Circuit), May 13, 1955 Petition filed.
Oct. 10, 1955 Petition granted, and case assigned for argument immediately following No. 34. Oral argument in each case will be limited to 45 minutes a side, and case now awaiting argument.

Dkt. 132—*Holophane Company, Inc.* v. *United States of America* (U. S. D. C., Southern Ohio), June 8, 1955 Appeal filed. Oct. 10, 1955 Probable jurisdiction is noted. Mr. Justice Harlan taking no part, and case now awaiting argument.

Dkt. 151—*United States of America* v. *E. I. du Pont de Nemours & Co. et al.* (U. S. D. C., Northern Illinois), June 14, 1955 Appeal filed. Oct. 10, 1955 Probable jurisdiction is noted, Mr. Justice Clark and Mr. Justice Harlan taking no part, and case now awaiting argument.

Dkt. 410—*American Airlines, Inc* v. *North American Airlines, Inc.* (District of Columbia Circuit), Sept. 21, 1955 Petition filed. Nov. 14, 1955 Petition granted, case transferred to summary calendar, and now awaiting oral argument.

Dkt. 448—*United States of America* v. *McKesson & Robbins, Inc.* (U. S. D. C., Southern New York), Oct. 4, 1955 Appeal filed. Dec. 12, 1955 Probable jurisdiction is noted and case transferred to summary calendar.

Dkt. 456—*Laskey Bros. of W. Va. Inc.* v. *Warner Bros. Pictures, Inc.* (Second Circuit). Oct. 10. 1955 Petition filed. Jan. 9, 1955 Petition denied.

Dkt. 472—*Productive Inventions, Inc.* v. *Trico Products Corporation* (Second Circuit), Oct. 17, 1955 Petition filed. Jan. 9, 1956 Petition denied. Mr. Justice Harlan taking no part.

Dkt. 485—*United States Gypsum Company* v. *National Gypsum Company* (U. S. D. C., District of Columbia), Oct. 24, 1955 Appeal filed. Jan. 16, 1956, noted Probable jurisdiction.

Dkt. 512—*Paramount Film Dist. Corp.* v. *Austin Theatre, Inc.* (Second Circuit), Nov. 10, 1955 Petition filed. Jan. 9, 1956 Petition denied.

Dkt. 558—*The Mac Investment Company* v. *The United States of America* (U. S. D. C., Eastern Michigan—So. Div.), Dec. 9, 1955 Appeal filed and now awaiting action.

Dkt. 642—*Students Book Co.* v. *Washington Law Book Co.* (Dist. of Col. Cir.), Jan. 26, 1956, Petition filed.

Dkt. 658—*North American Air Coach Systems, et al.* v. *North American Aviation, Inc.* (Ninth Cir.), Feb. 2, 1956, Petition filed and now awaiting action.

Dkt. 667—*Tractor Training Service, et al.* v. *Federal Trade Commission* (Ninth Cir.). Petition pending and now awaiting action.

Dkt. 672—*Balian Ice Cream Co., et al.* v. *Arden Farms Co.* (Ninth Cir.), Feb. 8, 1956, Petition filed and now awaiting action.

Other Federal Court Developments

Independent Poster Exchange v. *National Screen Service Corporation* (D. C. E. D. Pa., December 15, 1955). Judge Kirkpatrick refused the plaintiffs' motion for summary judgment in a civil action charging the defendant, Motion Picture Distributors, with

conspiracy to establish a monopoly for plaintiffs' competitor, the National Screen Service Corporation, who manufactured and distributed advertising accessories. National Screen had already been found guilty of violation of Sections 1 and 2.

The Court held, however, that merely having business dealings with the monopolist, even with knowledge of the monopoly, is not enough to show violation of the Sherman Act. The plaintiffs must show that each distributor contracted with National Screen with the specific intent to create a monopoly for National Screen.

On the other hand, where the monopolist or the one charged with monopoly itself enters into discriminatory contracts, specific intent may be inferred. This principle will not be carried over against one charged with conspiring to create a monopoly for another.

United States v. *International Boxing Guild* (D. C. N. D. Ohio, January 10, 1956). Upon the complaint of the Attorney General, the International Boxing Guild was indicted for violation of Section 1 of the Sherman Act on January 10, 1956.

The indictment charges an illegal conspiracy in which the Guild, an association of boxing managers, agreed to boycott and refuse to permit boxers under contract to them, to participate in bouts with non-member managed boxers or where non-managed boxers are permitted, and to refuse to permit their boxers participating in studio shows or in bouts where managers have provided studio boxers and in bouts not approved by the Guild.

The indictment charges further an agreement to fix minimum prices at which the boxers would participate in bouts being televised.

Department of Justice Activity

United States v. *Hilton Hotels Corporation, et al.* (D. C. N. D. Ill., February 6, 1956). The complaint filed in April 27, 1955 sought divestiture of hotels in New York, Washington, St. Louis, and Los Angeles acquired by Hilton Hotels as part of the acquisition of the Statler chain. Under the terms of the consent judgment filed on February 6, 1956, Hilton is required to dispose of one non-Statler hotel in each of these cities. In addition, the judgment prohibits Hilton Hotels from acquiring additional hotels in each of these cities before January 1, 1961, without the consent of the court. This action was one of five actions brought under amended Section 7

of the Clayton Act. The complaint had charged that the acquisition of the Statler chain by Hilton Hotels eliminated competition for convention business in the four cities in which both chains operate hotels. The Department of Justice had announced that this case was instituted to clarify the meaning of the language of Section 7, "in any line of commerce * * * in any section of the country."

United States v. *Western Electric Co. Inc. and American Telephone & Telegraph Co., et al.* (D. C. N. J., January 24, 1956). The complaint filed in January 1949 sought among other things the divestiture of Western Electric Co. from American Telephone & Telegraph Co., and the division of Western Electric's assets among three companies. Under the terms of the consent judgment entered on January 24, 1956, the defendants are required to grant unlimited licenses to domestic applicants under their present and future patents and to furnish technical information. The defendants are prohibited from manufacturing any equipment not useful in furnishing common carrier communications services and are prohibited from acquiring any company manufacturing or selling equipment useful in furnishing such services. Pursuant to these prohibitions, Western Electric is required to sell a subsidiary which makes sound recording equipment for the motion picture industry. Other provisions of the judgment are designed to limit the defendants to the field of furnishing communications services subject to public utility regulation.

United States v. *American Association of Advertising Agencies* (D. C. S. D. N. Y., February 1, 1956). The Department of Justice on February 1, 1956 entered in Federal Court in New York City of a consent judgment against the American Association of Advertising Agencies, Inc., terminating the Government's civil antitrust suit against this defendant.

The Government's complaint, filed May 12, 1955, charged the American Association of Advertising Agencies (4A's) of New York City and five media associations with combining and conspiring in restraint of interstate commerce in newspaper and periodical advertising in violation of Section 1 of the Sherman Act. The case remains for final disposition as to the five other defendants:

The American Newspaper Publishers Association, New York City

Publishers Association of New York City

Associated Business Publications, Inc., New York City

Periodical Publishers Association of America, New York City

Agricultural Publishers Association, Chicago, Illinois

The Government's complaint charged that the defendants entered into a continuing agreement pursuant to which the defendant publishers' associations adopted substantially uniform standards for recognition of advertising agencies and agreed that only those agencies so recognized would receive credit and agency commissions. It was also charged that the defendants agreed that agency commissions would be fixed and maintained at 15 percent of the publisher's gross rate for advertising. Each defendant association was additionally charged with conspiring with its members pursuant to which the members agreed to adhere to the arrangements made among all the associations.

The judgment entered today enjoins the defendant 4 A's from entering into or following any policy, course of conduct or agreement (1) fixing commissions for advertising agencies; (2) requiring or advising any agency not to split or rebate commissions; (3) designed to deny or limit commissions due or available to any agency or (4) establishing any recognition system.

In addition, the defendant association is specifically prohibited from assisting any of its members to engage in the practices forbidden to it by the judgment. Finally the judgment requires that the defendant conform its charter, by-laws, etc. to the terms of the decree, and that the judgment be circulated to old and new members.

In connection with the entry of the judgment Assistant Attorney General Stanley N. Barnes head of the Antitrust Division said:

"It is believed that the termination of this case as to defendant 4 A's will assure the public and members of all branches of the advertising business that 4 A's will no longer participate either in fixing thte rate of advertising agency commissions or in influencing newspapers or other advertising media as to the agencies with whom advertisers should do business."

United States v. *International Business Machines Corp.* (D. C. S. D. N. Y., January 25, 1956). In a complaint filed on January 21, 1952, I. B. M. was charged with unlawfully restraining and monopolizing the tabulating card and machine industry through,

among other things, I. B. M.'s leasing of tabulating machines and its refusal to sell machines, the monopolization of patents and the use of restrictive provisions in its leasing agreements. On January 25, 1956 the action was terminated with the entry of a consent judgment which requires I. B. M. to offer for sale in perpetuity new tabulating machines and electronic data processing machines. Provision is made for giving lessees a limited option to purchase machines, and requiring I. B. M. to provide service and repair and replacement parts. I. B. M. is also directed to grant non-exclusive licenses under its existing patents and under patents acquired or applied for within the next five (5) years. These provisions are implemented with the further requirement that I. B. M. furnish technical know-how, training and instruction manuals. The judgment also provides for the divestiture in 1963 of I. B. M.'s card manufacturing facilities which are in excess of 50% of the then total card manufacturing capacity in the United States, unless I. B. M. can show to the court that competitive conditions exist.

Federal Trade Commission Activities

Maryland Baking Co., FTC Dkt. 6327 (Init. Decision, Feb. 17, 1956).

The Maryland Bakery Co. lowered its prices for ice cream cones in only one trade area to drive out competition. In an initial decision containing an order to stop this practice, Hearing Examiner Everett F. Haycraft said, in effect, that the Robinson-Patman Act, prohibiting price discrimination which lessens competition, "was intended to reach just such a practice."

This is not a final decision of the Commission and may be appealed, stayed or docketed for review.

When faced with competition for the first time in one trading area, the examiner said, Maryland Baking "in retaliation," dropped its jobber price for cones by $1.66 to $5.00 per thousand while maintaining a price of $7.16 in another area. This practice, the examiner said, though "not completely successful in driving its smaller competitor . . . out of business . . . was successful in inflicting serious injury to this lone competition" and is a violation of Sec. 2(a) of the Clayton Act as amended by the Robinson-Patman Act.

In 1951, the examiner said, a competitor began selling rolled sugar cones to jobbers in the metropolitan areas of Baltimore, Hagerstown and Frederick, Md., and Washington, D. C. Maryland Baking at that time, threatening to drive out the competition, dropped its jobber price.

As a result of this price drop, the examiner said, the competitor lost all its sales to some jobbers in 1951 and to others in succeeding years.

The examiner's order would prohibit the Maryland Baking Co., from discriminating in the price of ice cream cones if in the sale to the customer charged the lower price, the firm is in competition with another seller.

Foremost Dairies, Inc., FTC Dkt. 6495 (Complaint, Jan. 20, 1956).

The Federal Trade Commission charged Foremost Dairies, Inc., of Jacksonville, Fla., with violating the anti-merger law as a result of the overall impact on competition of its acquisitions of other dairy companies. Since 1951, Foremost has acquired 39 companies producing dairy products.

A Commission complaint charges, in effect, that Foremost's pattern of acquisitions over the years injures free competition in dairy products, and violates both Sec. 7 of the Clayton Act (the anti-merger law) and Sec. 5 of the FTC Act.

Foremost is described in the complaint as one of the four largest purchasers, processors and distributors of dairy products, including milk, canned fresh milk, ice cream, cheese, butter and eggs. The 39 acquired firms, the complaint states, were members of the industry.

The complaint alleges that the acquisitions represent a "constant and systematic elimination of actual and potential competitors," and, as such, constitute an unfair method of competition in violation of Sec. 5 of the FTC Act.

The Clayton Act charges concern the 30 acquired firms which were corporations. Sec. 7 prohibits the acquisition of the stock or assets of ccorporations if the effect may be a substantial lessening of competition or tendency toward monopoly.

Acquisition of the nine remaining firms was challenged under the FTC Act alone, inasmuch as Clayton Act prohibitions apply only to incorporated firms. The nine were individually owned com-

panies in Florida. However, the complaint alleged that their acquisition by Foremost is part of the systematic elimination of competition carried on by that corporation.

The complaint alleges that as a result of these acquisitions Foremost increased its gross sales from $52 million in 1950 to $375 million in 1954.

The complaint notes further that prior to 1950 Foremost acquired the stock or assets of 38 additional dairy firms. In addition, Foremost merger with the Maxon Food System, Inc., in 1949. In 1932, Foremost's first year of operation, the complaint continues, the gross sales approximated $1 million as contrasted to the 1950 figure of $52 million.

Among the alleged adverse competitive effects are the following:

The acquisitions have eliminated a number of independent small business concerns;

Industry-wide concentration may be increased;

Actual and potential competition in the industry may be substantially lessened;

Foremost's competitive advantage may be enhanced to the detriment of actual and potential competition.

The complaint alleges that the purchase of five of the 39 firms involved in today's action included the acquisition of their subsidiaries, an additional 25 firms.

Magnesium Company of America, FTC Dict. 6370 (consent order, Jan. 16, 1956).

The Federal Trade Commission apporved a consent order forbidding price discrimination by Magnesium Company of America, Inc., East Chicago, Ill., in the sale of its dockboards, loading ramps, and other materials handling equipment.

The order follows a Commission complaint, issued June 27, charging that through purchase discounts the firm was giving price advantages to certain customers in violation of the Clayton Act as amended by the Robinson-Patman Act. The complaint had charged that the practice diverted business from the firm's competitors and threatened to lessen competition or create a monopoly.

The consent settlement entered into by the firm and counsel supporting the complaint was approved by Hearing Examiner James A. Purcell, who issued the order approved today by the Commission.

The order specifically prohibits direct or indirect price discrimination in materials handling equipment where the firm is in competition with other sellers.

The agreement is for settlement purposes only and does not constitute an admission by the company that it has violated the law.

Cordova District Fisherman's Union, FTC Dkt. 6369 (consent order, Feb. 13, 1956).

The Federal Trade Commission approved a consent order prohibiting the fishermen and canners in the Cordova, Alaska area from fixing prices of Dungeness crab and crabmeat.

The Cordova District Fishermens Union, representing the fishermen in the area, and three canning firms agreed to the order during negotiations with Commission counsel. The agreement was approved by the Commission hearing examiner who issued the order made final by the present action.

The order specifically prohibits "fixing, establishing, maintaining or adhering to" or negotiating for fixed prices in the buying and selling of the product.

The Commission, in a complaint issued June 27, 1955, had charged the Union, P. O. Box 939, Cordova, and the three firms, representing a substantial part of the industry, with contracting to fix minimum prices canners pay the fishermen. This activity, the complaint had alleged, restrains competition and tends to "unduly enhance" the price the public pays for the product.

The Commission's order contains these provisions:

> That nothing contained in the order will prevent the lawful activities of an association of fishermen or collective bargaining concerning employee wages and working conditions;
>
> That nothing contained in the order will prohibit the existence of "bona fide" partnerships, joint operations or consolidations for operation of canneries where prices paid for crab or crabmeat are set.

The latter provision, however, is not to be construed as approval or disapproval by the Commission of any such enterprise or as

Commission permission for the continuation or formation of such enterprises with the effect of "rendering ineffective or unenforceable the inhibitions" and purposes of the order.

The agreement is for settlement purposes only and does not constitute an admission by the parties that they have violated the law.

Warren Petroleum Corp., FTC Dkt. 6227 (Init. Decision, February 10, 1956).

A Federal Trade Commission Hearing Examiner dismissed charges that Warren Petroleum Corp., Tulsa, Okla., or its affiliates, Butane Wholesale Gas Co., Little Rock, Ark., and Zero LP-Gas Co., Lake Village, Ark., have restrained trade in the sale of liquefied petroleum
Village, Ark., have restrained trade in the sale of liquefied petroleum
gas in the Lake Village, Ark. area.

Hearing Examiner Abner E. Liscomb ruled in an initial decision that charges that the firms had lowered prices in the area in 1952 and 1953 to drive out competition were not sustained by the evidence.

This is not a final decision of the Commission and may be appealed, stayed or docketed for review.

The examiner, on motion of counsel supporting the complaint, also dismissed the charge that Warren had discriminated in the price charged its customers for LP-Gas in violation of Sec. 2(a) of the Clayton Act as amended by the Robinson-Patman Act.

Warren Petroleum Co., acquired 51% of the stock in Butane Wholesale Gas Co., in 1950. This firm, in turn, wholly owns Zero LP-Gas Co., a retail outlet formed in 1952 to distribute LP-Gas in the Lake Village area. The complaint, issued June 30, 1954, charged that Warren, through control of Butane, was responsible for alleged price-cutting of from 3¢ to 4¢ per gallon retail, by Zero in the area, with the intent of injuring, suppressing and destroying competition.

The examiner ruled that Warren purchased Butane as an investment and did not direct or control its affairs. It is settled, the examiner said, that "mere ownership" of corporate stock is not enough to make the owning corporation responsible for the activities of the subsidiary.

Butane, on the other hand, the examiner said, does control the affairs of Zero and is responsible for its activities. "The evidence, however," the examiner said, "in dicates only that Respondent Zero

LP-Gas Company lowered its price to meet competition, in order to survive in a very competitive trading area."

The lowest price for which Zero sold gas, 7¢ per gallon, was not, as charged, 3¢ to 4¢ under the prevailing retail price, the examiner said. At least one competitor charged 6½%.

Other evidence shows, the examiner added, that in 1953 the retail distributors in the area held a meeting and asked Zero to join in an agreement to fix prices. Zero declined but raised its price to 8½¢ when the other dealers raised their prices to this figure following the meeting.

The establishment of a monopoly in this area by Zero or Butane was "practically impossible," the examiner concluded. This would have involvved driving out eleven or twelve retailers, with five larger than Zero, as well as eight wholesalers including "such economic giants as Gulf Oil Co., Phillips Petroleum Company and Lion Oil Company."

Congressional Activities

SELECT COMMITTEE ON SMALL BUSINESS

Hearings on New Jersey Gasoline Price Wars Continued on Saturday, February 18, at 10:00 A.M., Room 457, Senate Office Building, before the Subcommittee on Retailing, Distribution, and Fair Trade Practices, Senator Hubert H. Humphrey, Chairman. Scheduled witnesses include John W. Gwynn, Chairman of the Federal Trade Commission, and members of the FTC staff. The purpose of this hearing is to obtain an accounting of the action taken by the FTC to prohibit the use of marketing practices which tend to prolong and intensify gasoline price wars.

Price Discrimination in Book Field Ended by Publishers Agreement with the Federal Trade Commission as the result of an FTC complaint filed in June, 1955, against Houghton Mifflin Co., Little, Brown & Co., Random House, Inc., and Simon & Schuster, Inc. The complaint alleged that the four major publishers practiced price discrimination in that they held book stores to a single fixed price while allowing large discounts to book clubs. In reaching the agreement to discontinue such practices, the publishing companies did not admit that their actions had been illegal.

President's Economic Report Paralleled Anti-Merger Bill of Senator Sparkman. The anti-merger recommendations of the Economic Report closely followed the major provisions of the omnibus anti-merger measure proposed by Senator Sparkman. The Report and Senator Sparkman's proposals both call for 1) application of Section 7 of the Clayton Act to all types of bank mergers; 2) a requirement of advance notice to the Justice Department and the Federal Trade Commission by companies planning a significant merger; 3) FTC cease-and-desist orders to be final, unless appealed to the courts; 4) application of Section 7 where either party to a merger is in interstate commerce. In addition to the above, Senator Sparkman's measure would also provide for giving the FTC pre-merger injunctive powers and the provision of equitable remedies in addition to divestiture. The Economic Report also proposed a requirement for Federal approval of the acquisition of banks by holding companies and in civil cases would grant power to the Attorney General to issue an investigative demand compelling the production of documents before the filing of a complaint and without the necessity of recourse to grand jury proceedings.

Questionnaire on Fair Trade Sent to Selected Retailers by the Subcommittee on Retailing, Distribution, and Fair Trade Practices. Senator Hubert H. Humphrey, Subcommittee Chairman, stated that the questionnaire "evolved from a pilot questionnaire which was sent to retailers several weeks ago. The response to the earlier questionnaire has been gratifying and has given us some very helpful information. We anticipate even better results from this questionnaire."

Legislation

Legislation enaccted in the Union of South Africa empowers the Board of Trade and Industries to make investigations to determine if monopolistic conditions exist in an industry. The Government is empowered to dissolve any association and suspend duties on imported goods if these actions are necessary to prevent monopolistic conditions. Violators of the law are also subject to fines of up to £10,000 ($280.000) and/or 5 years in prison.

Rep. James Roosevelt has introduced a "freedom of choice" bill designed to protect small dealers from coercion by big supplies. The bill provides that a dealer may establish a prima facie case

"whenever there has been a threat or an act of cancellation, termination or refusal to renew a contract to sell, lease, license, or franchise." The bill provides that where the court finds "reasonable cause" for the filing of the suit, the government shall bear litigation costs of plaintiffs who are unsuccessful and who cannot bear the costs without "undue hardship."

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SIDNEY A. DIAMOND NOW WITH KAYE, SCHOLER.

Sidney A. Diamond is now associated with the firm of Kaye, Scholar, Fierman and Hays of New York City. Mr. Diamond was previously with the New York law firm of Roosevelt, Freidin and Littauer. Author of numerous law review articles, most recent article entitle "Antitrust Problems of Fair Trading" appeared in the the May Issue of this publication. Mr. Diamond was formerly a Special Assistant to the Attorney General, Antitrust Division, Department of Justice.

Notes

A. Heckscher New 20th Century Fund Director

August Hecksher, formerly chief editorial writer of the Herald Tribune has been named Director of the Twentieth Century Fund replacing Dr. J. Frederic Dewhurst, who will head a new project on Europe's Needs and Resources.

Caplan Quits as Chief Counsel of Patent Subcommittee

Chief Counsel Julian Caplan, of the Senate Subcommittee on Patents, Trademarks and Copyrights, is returning to the private practice of law in San Francisco, Chairman Joseph C. O'Mahoney (D. Wyo.) announced Jan. 31. Since August, the subcommittee has been engaged in examining and reviewing the patent laws and the administration of the Patent Office. One result of the work already accomplished has been a great increase in the planned size of the Patent Office examining corps in order to reduce the length of time which an inventor must wait in order to get action on his patent application. Another important result has been a re-focusing of attention upon the individual inventor and his problems in attempting to finance, patent, and develop his invention in competition with the vast research laboratories which have been grinding out an increasingly large percentage of the Nation's patents. Improvement in the private invventor's chances of success in stopping infringement of his rights is one of the chief developments looked for as a result of the subcommittee's action thus far. The subcommittee study will continue through the present session, subject to the approval of the Senate, Chairman O'Mahoney said, and Mr. Caplan will be available on a consultative basis.

"The patent system stems from an ancient exception to our traditional abhorrence of monopolities in every other guise," Senator O'Mahoney said, "and this exception is based upon the well-founded theory that by giving the inventor a limited exclusive right for a limited period of time he will be encouraged to make the sacrifices of time and mental and physical effort necessary to originate and to perfect new devices and new methods upon which advance of our civilization and evven our national existence depend. As is true in many other fields of endeavor, the individual is being shouldered out of the way by collective enterprise, in this instance augmented by million-dollar laboratories and swarms of engineers and scientists.

This is not to say that the corporate research laboratory should be abolished or in any way impaired in its necessary functions, but the freedom of opportunity of the individual possessing inventive genius must be preserved and his interests must be the paramount consideration in any rational appraisal of the patent system."

"Mr. Caplan has given unstintingly of his time and effort in organizing the program and staff so that it is now equipped to carry on its study of ways and means of improvement of the lot of the individual inventor and abolition of monopolistic abuses of patents. His training and experience, not only in the patent law but also in the field of antitrust law, have been a valuable asset in the work of the subcommittee. His commitment was originally of limited duration, and it is now necessary for him to return to his home and practice in San Francisco," Senator O'Mahoney said.

Announcement of the appointment of new subcommittee counsel will shortly be forthcoming.

LONDON AMERICAN CHAMBER OF COMMERCE ISSUES REPORT.

The American Chamber of Commerce in London issued a 30 page pamphlet, "The Americcan Antitrust Laws and American Business Abroad," urging the exemption from U. S. antitrust laws of acts performedm outside the territorial limits of the U. S.

The Chamber claims that extension of the law to acts abroad, when these acts affect U. S. foreign trade, is a "radical departure" from Supreme Court doctrine, and contrary to our policy of promoting foreign trade and investment.

MERGER LEGISLATION LIKELY

A wave of bills designed to amend the anti-merger provisions of the CSlayton Act are scheduled for introduction in both houses during the current Congressional session. The most comprehensive will be an Omnibus anti-merger bill," to be proposed by Senator John S. Sparkman (D-Ala.). This bill would amendment Section 7 of the Clayton Act to provide:

1. Application of Section 7 to bank mergers accomplished by asset acquisition.

2. Requirement of prior notice to FTC and the Dept. of Justice by corporations planning to merge. (This provision has been supported by both departments, the Attorney-General favor-

ing its application to corporations with $10 million or more in assets.)

3. Compulsory submission of report to FTC and Dept. of Justice by corporations planning to merge.

4. Pre-merger injunctive powers for the FTC.

5. Equitable remedies in addition to divestiture in merger cases.

6. Finality of Clayton Act orders.

7. Application of Section 7 where either acquiring or acquired corporation is in interstate commerce.

These proposals havve been endorsed by the FTC and the Dept. of Justice, while the banking provision is supported by the Federal Deposit Insurance Corporation and Federal Reserve Board as well. Furthermore, in order to step up their enforcement activities under current law, both antitrust agencies will increase appropriations requests for the next fiscal year. The FTC will, according to Chairman John W. Gwynne, will ask for $1.25 million for anti-merger activities in the year starting July 1, 1956, an increase of $951,500 over the sum used during the current fiscal year. The additional funds would be used to hire 165 more employees, including 100 lawyers. The budget request for the Dept. of Justice's Antitrust Division for the next fiscal year has also been increased, from a present $3.1 million to $4.265 million.

The merger problem is also being attacked from another direction. A recent report of the Joint Committee on the Economic Report ("Federal Tax Policy For Economic Growth and Stability") suggested a reappraisal of the tax laws "in terms of their impact on the ability of small-and-medium-size companies to resist inducement for absorption into largger units," and hinted at a future intention to propose a greater differential in effective rates applicable to small and large corporate taxpayers. Representative Wright Patman (D-Tex.) has already made known a stand in favor of tax revision aimed at reducing merger activity.

THE EISENHOWER BUDGET

The new budget submitted by the administration for the fiscal year beginning July 1, 1956 calls for increased expenditures on anti-

trust enforcement. The President has asked $5,300,000 for the Federal Trade Commission, and $4,265,000 for the Antitrust Division of the Department of Justice. These sums compare with $4,600,000 and $3,100,000, respectively, whicch were allotted for the fiscal year ending this June 30.

The bulk of the Commission's new funds will be used for stepped-up enforcement of the Clayton Act, particularly Section 7. It is also reported that a portion of the Antitrust Division's increment will be used to cover the costs of annual report which the Attorney General must now file on the activities of the Interstate Compact to Conserve Oil and Gas.

Cartels in Germany

In mid-January the Economics Committee of the West German Budestag once again took up consideration of the anti-cartel law introduced in 1952 by Economics Minister Ludwig Erhard. The present version of the bill represents what has been described as "a pale shadow" of the bill Erhard and the Allies had hoped for. Although cartels restraining competition are outlawed, the exceptions are so numerous as to make that proscription meaningless. Exempted are "crisis cartels" (those set up in response to a temporary decline in industry sales), cartels which aim to increase efficiency; cartels which are formed to established uniform methods of setting prices; and those designed to protect or promote foreign trade.

The one remaining provision to which industry objects calls for the creation of federal cartel authority with power to require firms to supply cost, price, profit and other data.

Allied and German observers are agreed that there is little possibility of getting anything but a very weak bill through the Parliment. They point out that the legislators' friendly attitude towards business is unlikely to change, as the approaching 1957 elections increases the importance to all parties of business' campaign contributions.

Fair Trade Foe Enters State Politics

Mr. Schwegmann, a New Orleans supermarket operator famous for his opposition to fair trade is running on an anti-fair trade ticket for the state senate in Louisiana.

Concentration in the Automobile Industry Deplored by Stanley N. Barnes, Assistant Attorney General, in a Speech Before the National Wholesale Dry-goods Association

Mr. Barnes pointed out that in 1949, General Motors, Ford, and Chrysler held 85 per cent of the market, with six smaller firms sharing the remaining 15 per cent. In 1954, the Big Three sold 95.5 per cent of the industry's output, with only three small firms fighting for the remaining $4\frac{1}{2}$ per cent. Mr. Barnes hinted that some antitrust action to correct this situation might be undertaken.

Eugene Holman New Business Advisory Council Chairman

Eugene Holman, board chairman of the Standard Oil Co. of N. J., has been elected Chairman of the Commerce Department's Business Advisory Council. Robert B. Anderson, former deputy defense secretary who now heads Ventures, Ltd., was elected to membership of the Council.

Quantity Discount Rule Challenged

The Department of Justice has appealed the Federal District Court ruling which threw out the Federal Trade Commission's case against the quantity discounts offered by the major tire companies. The Commission's rule would prohibit a tire company from giving a purchaser a discount larger than that given on a single freight carload. The Court of Appeals decision is not expected until April or May at the earliest, but already interest in the case is mounting, as the quantity discount proviso involved came under severe attack by the Attorney General's committee, which cited it as sanctioning "a crude form of price-fixing by administrative fiat. . . ."

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